

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15 (d) of the  
Securities Exchange Act of 1934

For the quarterly period ended June 27, 1997

Commission File Number: 1-9249

GRACO INC.

-----  
(Exact name of Registrant as specified in its charter)

Minnesota

41-0285640

-----  
(State of incorporation)

-----  
(I.R.S. Employer Identification Number)

4050 Olson Memorial Highway  
Golden Valley, Minnesota

(55422)

-----  
(Address of principal executive offices)

-----  
(Zip Code)

(612) 623-6000

-----  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

Yes      X              No  
-----              -----

17,063,799 common shares were outstanding as of July 31, 1997.

GRACO INC. AND SUBSIDIARIES

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Executive Long Term Incentive Agreement. Form of restricted stock award agreement used for award to one executive officer, dated May 6, 1997.	Exhibit 10.11
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## PART I

## GRACO INC. AND SUBSIDIARIES

## Item I. CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	June 27, 1997	June 28, 1996	June 27, 1997	June 28, 1996
	(In thousands except per share amounts)			
Net Sales .....	\$ 111,721	\$ 97,099	\$ 203,820	\$ 187,252
Cost of products sold .....	58,322	47,677	105,888	92,993
Gross Profit .....	53,399	49,422	97,932	94,259
Product development .....	4,828	4,623	9,653	8,852
Selling .....	23,764	21,240	45,397	41,090
General and administrative .....	8,284	10,005	16,839	21,680
Operating Profit .....	16,523	13,554	26,043	22,637
Interest expense .....	240	345	447	577
Other (income) expense, net .....	615	(1,323)	247	(757)
Earnings Before Income Taxes .....	15,668	14,532	25,349	22,817
Income taxes .....	5,250	4,500	8,750	7,200
Net Earnings .....	\$ 10,418	\$ 10,032	\$ 16,599	\$ 15,617
Net Earnings Per Common and Common Equivalent Share .....	\$ .60	\$ .57	\$ .95	\$ .89
Cash Dividend Per Common Share .....	\$ .14	\$ .12	\$ .28	\$ .24

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(In thousands)

	June 27, 1997	December 27, 1996
ASSETS	----- (Unaudited)	-----
Current Assets:		
Cash and cash equivalents	\$2,258	\$6,535
Accounts receivable, less allowances of \$4,224 and \$4,700	89,903	83,474
Inventories	43,405	41,531
Deferred income taxes	12,306	11,633
Other current assets	1,536	1,321
	-----	-----
Total current assets	149,408	144,494
Property, Plant and Equipment:		
Cost	191,600	183,085
Accumulated depreciation	(92,078)	(88,913)
	-----	-----
	99,522	94,172
Other Assets		
	9,398	9,148
	-----	-----
	\$258,328	\$247,814
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Notes payable to banks	\$12,321	\$3,813
Current portion of long-term debt	1,827	1,845
Trade accounts payable	14,589	13,854
Salaries, wages & commissions	12,990	14,808
Accrued insurance liabilities	11,692	10,925
Income taxes payable	7,086	4,647
Other current liabilities	20,897	30,718
	-----	-----
Total current liabilities	81,402	80,610
Long-term Debt, less current portion	7,222	8,075
Retirement Benefits and Deferred Compensation	34,161	33,079
Shareholders' Equity:		
Common stock	17,064	17,047
Additional paid-in capital	21,106	22,254
Retained earnings	95,856	85,232
Other, net	1,517	1,517
	-----	-----
	135,543	126,050
	-----	-----
	\$258,328	\$247,814
	=====	=====

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

Twenty-Six Weeks

-----  
June 27, 1997      June 28, 1996  
-----

CASH FLOWS FROM OPERATING ACTIVITIES:

(In thousands)

Net Earnings	\$16,599	\$15,617
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	7,284	6,563
Deferred income taxes	(1,715)	841
Change in:		
Accounts receivable	(8,832)	(3,358)
Inventories	(3,042)	(5,779)
Trade accounts payable	950	(1,025)
Retirement benefits and deferred compensation	1,286	628
Other accrued liabilities	(7,633)	1,786
Other	(1,055)	(774)
	-----	-----
	3,842	14,499
	-----	-----

CASH FLOWS FROM INVESTING ACTIVITIES:

Property, plant and equipment additions	(12,881)	(9,600)
Proceeds from sale of property, plant, and equipment	1,555	6
	-----	-----
	(11,326)	(9,594)
	-----	-----

CASH FLOWS FROM FINANCING ACTIVITIES:

Borrowing on notes payable and lines of credit	37,420	12,657
Payments on notes payable and lines of credit	(28,805)	(11,650)
Borrowing on long-term debt	-	142
Payments on long-term debt	(714)	(1,028)
Common stock issued	2,850	2,309
Retirement of common stock	(5,145)	(3,540)
Cash dividends paid	(4,836)	(4,221)
	-----	-----
	770	(5,331)
	-----	-----

Effect of exchange rate changes on cash	2,437	1,123
	-----	-----

Net increase (decrease) in cash and cash equivalents	(4,277)	697
--	---------	-----

Cash and cash equivalents:

Beginning of year	6,535	1,643
	-----	-----
End of period	\$2,258	\$2,340
	=====	=====

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. The consolidated balance sheet of Graco Inc. and Subsidiaries (the Company) as of June 27, 1997 and the related statements of earnings for the thirteen and twenty-six weeks ended June 27, 1997, and June 28, 1996, and cash flows for the twenty-six weeks ended June 27, 1997, and June 28, 1996, have been prepared by the Company without being audited.

In the opinion of management, these consolidated statements reflect all adjustments necessary to present fairly the financial position of Graco Inc. and Subsidiaries as of June 27, 1997, and the results of operations and cash flows for all periods presented.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. Therefore, these statements should be read in conjunction with the financial statements and notes thereto included in the Company's 1996 Form 10-K.

The results of operations for interim periods are not necessarily indicative of results which will be realized for the full fiscal year.

2. Major components of inventories were as follows (in thousands):

	June 27, 1997	Dec 28, 1996
Finished products and components	\$43,349	\$38,707
Products and components in various stages of completion	25,708	24,691
Raw materials	12,382	15,192
	81,439	78,590
Reduction to LIFO cost	(38,034)	(37,059)
	\$43,405	\$41,531
	=====	=====

3. Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings per Share," was issued in February, 1997 and requires adoption for annual periods ending after December 15, 1997. Earnings per Share determined in accordance with SFAS No. 128 are not materially different than the current disclosure under APB Opinion No. 15.

Item 2.

GRACO INC. AND SUBSIDIARIES  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations  
-----

Net earnings of \$10.4 million for the quarter ended June 27, 1997 increased 4 percent over the second quarter of 1996 earnings of \$10.0 million. For the six months ended June 27, 1997, net earnings of \$16.6 million were 6 percent over 1996 earnings of \$15.6 million. The quarterly earnings improvement was driven by higher sales. A decrease in gross profit margins, a slight increase in operating expenses, exchange losses due to currency fluctuations and a higher effective tax rate partially offset the enhanced sales results. Also, the second quarter of 1996 includes the receipt of a \$1.5 million pretax settlement of a lawsuit.

The following table sets forth items from the Company's Consolidated Statements of Earnings as percentages of net sales:

	Second Quarter (13 weeks) Ended		Six Months (26 weeks) Ended	
	June 27 1997	June 28 1996	June 27 1997	June 28 1996
Net Sales	100.0%	100.0%	100.0%	100.0%
Cost of Products Sold	52.2	49.1	52.0	49.7
Product Development	4.3	4.8	4.7	4.7
Selling	21.3	21.8	22.3	21.9
General and Administrative	7.4	10.3	8.3	11.6
Operating Profit	14.8	14.0	12.7	12.1
Interest Expense	(.2)	(.4)	(.2)	(.3)
Other Income(Expense), Net	(.6)	1.4	(.1)	.4
Earnings Before Income Taxes	14.0	15.0	12.4	12.2
Income Taxes	4.7	4.7	4.3	3.9
Net Earnings	9.3%	10.3%	8.1%	8.3%

Net Sales

Net sales in the second quarter of \$111.7 million were 15 percent higher than the same period last year. Year-to-date sales of \$203.8 million were 9 percent higher than the first six months of 1996. The improved sales level was achieved despite a negative currency impact, which reduced sales by 3 percent for the quarter and 2 percent for the six month period.



Industrial/Automotive Division sales improved 9 percent to \$57.2 million, driven by strong demand for industrial products in the Americas and Europe as well as automotive systems in Europe. Sales for the six month period ended June 27, 1997 in Industrial/Automotive of \$107.4 million were 7 percent higher than 1996. Second quarter Contractor Division sales of \$42.1 million were 27 percent higher than last year due primarily to new product introductions. Additionally, a new pricing structure in the Contractor Division implemented in 1997 is resulting in a seasonal change in demand from 1996 when price promotions forced more activity into the first quarter. Year-to-date sales in the Contractor division were up 11 percent to \$73.4 million. Lubrication Division quarterly sales increased 9 percent to \$12.4 million, reflecting a healthy North American economy and an increased key distributor base. Sales of \$23.0 million for the first six months in Lubrication were up 8 percent over the same period last year.

Geographically, sales in the Americas (North, South and Central) increased 19 percent to \$75.9 million for the quarter primarily due to strong Contractor activity, partially offset by sluggish automotive systems activity. Year-to-date sales in the Americas of \$138.5 million are up 10 percent over the same period last year. European quarterly sales of \$21.9 million were 29 percent higher than last year (including a 10 percent decline due to exchange rates). European sales for the six months ended June 27, 1997 of \$38.8 million improved 18 percent from the same period last year (including an 8 percent decline due to exchange rates). The growth in Europe was attributable primarily to strong automotive systems activity and improved results in the Contractor Division. Asia Pacific sales of \$13.9 million were 13 percent lower than last year's second quarter (including an 8 percent decline due to exchange rates). Poor sales performance in Japan contributed to the decline. Sales in Asia Pacific for six months of \$26.5 million were 7 percent lower than last year (a 1 percent volume increase, offset by an 8 percent decline due to exchange rates).

#### Gross Profit

Gross profit as a percentage of net sales declined to 47.8 percent in the second quarter, compared to 50.9 percent for the same period last year. Gross profit margin for six months of 48.0 percent dropped 2.3 percentage points from the 1996 rate. The decreases for the quarter and six months were primarily the result of a shift in the product mix within the Contractor Division to an upgraded product line which generates a lower margin than other products and an increase in automotive systems activity. The strengthening of the U.S. dollar also reduced the gross margin as a greater proportion of the Company's sales are denominated in currencies other than the U.S. dollar than are costs.

#### Operating Expenses

Second quarter operating expenses of \$36.9 million increased 3 percent from the second quarter of 1996. Operating expenses of \$71.9 million for the first six months were at the 1996 level. Quarterly product development expense increased 4 percent over 1996, reflecting the Company's commitment to expanding sales through the development of new products. Selling expenses were 12 percent higher than the same quarter last year, largely due to increased sales levels, distributor training programs and sales force automation costs. General and administrative costs declined 17 percent from the second quarter of 1996 as a result of lower compensation and benefit accruals and reduced information system development costs.

#### Other Income (Expense)

Other expense was \$.6 million in the second quarter, compared to \$1.3 million of income for the same period last year. The second quarter of 1997 was unfavorably affected by foreign exchange rate changes, while 1996 was favorably impacted by the receipt of a \$1.5 million pretax lawsuit settlement. Other expense for the six months ended June 27, 1997 was \$.2 million, compared to \$.8 million of income in the same period of 1996.

#### Income Taxes

The quarterly and six month effective income tax rates increased to 33.5 percent and 34.5 percent, respectively compared to 31.0 percent and 31.5 percent for the same periods last year. The higher rates in 1997 were principally due to higher effective rates on foreign earnings.

#### Liquidity and Capital Resources

-----

The Company generated \$3.8 million of cash flow from operating activities in the first six months of 1997, compared to \$14.5 million for the same period last year. Significant uses of operating cash flow in 1997 resulted from an increase in accounts receivable balances, attributable to higher sales levels, and a reduction in other accrued liabilities, most significantly the reserve established in the prior year for the relocation of the Company's Franklin Park, Illinois operations. Operating cash flow was also used to fund an increase in inventory levels which was driven by higher engineered systems activity in the foreign operations and anticipated demand for the upgraded product line in the Contractor Division. Available cash and borrowing on lines of credit of \$37.4 million were used to fund short-term operating needs, finance capital expenditures of \$12.9 million and pay dividends of \$4.8 million. The Company had unused lines of credit available at June 27, 1997 totaling \$65.0 million. The available credit facilities and internally-generated funds provide the Company with the financial flexibility to meet liquidity needs.

#### Outlook

The Company is optimistic about the balance of the year, but does not expect to record double digit sales increases in the third and fourth quarters. Backlog at June 27, 1997 stands at \$25.3 million, up \$6.1 million since the beginning of the year. The Company has introduced a number of new products in 1997 and believes that its marketing strategies and continued investments in product development and manufacturing should have a positive impact on the Company in 1997 and its long-term ability to grow profitably.

SAFE HARBOR CAUTIONARY STATEMENT

The information in this 10Q contains "forward-looking statements" about the Company's expectations of the future, which are subject to certain risk factors that could cause actual results to differ materially from those expectations. These factors include economic conditions in the United States and other major world economies, currency exchange fluctuations, and additional factors identified in Exhibit 99 to the Company's Report on Form 10-K for fiscal year 1996.

PART II

Item 4. Submission of Matters to a Vote of Security Holders.

At the Annual Meeting of Shareholders held on May 6, 1997, George Aristides and Ronald O. Baukol were elected to the Office of Director with the following votes:

	FOR -----	WITHHELD -----
George Aristides	15,872,873	35,497
Ronald O. Baukol	15,885,568	22,802

At the same meeting, the following matters were also voted upon with the votes as indicated:

An amendment to the Long Term Stock Incentive Plan to include an annual per person aggregate limit was approved, with the following votes:

For -----	Against -----	Abstentions -----	Broker Non-Vote -----
15,697,160	152,531	58,679	0

The selection of Deloitte & Touche as independent auditors for the current year was approved and ratified, with the following votes:

For -----	Against -----	Abstentions -----	Broker Non-Vote -----
15,838,196	25,831	44,343	0

No other matters were voted on at the meeting.

PART II (cont.)

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Restated Bylaws	Exhibit 3
Seventh Amendment to Credit Agreement dated May 27, 1997 between the Company and First Bank National Association.	Exhibit 4
Key Employee Agreement. Form of agreement with officers and other key employees, dated April 2, 1997.	Exhibit 10.1
First Amendment of Graco Inc. Deferred Compensation Plan Restated, effective September 1, 1996.	Exhibit 10.2
Long Term Stock Incentive Plan as amended May 6, 1997.	Exhibit 10.3
Nonemployee Director Stock Plan as amended May 6, 1997.	Exhibit 10.4
Nonemployee Director Stock Option Plan as amended May 6, 1997.	Exhibit 10.5
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Financial Data Schedule	Exhibit 27

(b) No reports on Form 8-K have been filed during the quarter for which this report is filed.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GRACO INC.

Date: August 7, 1997

By: /s/George Aristides  
George Aristides  
Chief Executive Officer

Date: August 7, 1997

By: /s/James A. Graner  
James A. Graner  
Vice President & Controller  
("duly authorized officer")

RESTATED BYLAWS

GRACO INC.  
(Adopted May 6, 1997)

ARTICLE I.  
OFFICES, CORPORATE SEAL

Section 1.01. Offices. The principal executive office of the corporation shall be at 4050 Olson Memorial Highway, Golden Valley, Minnesota 55422. The corporation may have such other offices, within or without the State of Minnesota, as the directors shall, from time to time, determine.

Section 1.02. Corporate Seal. The corporate seal shall be circular in form and shall have inscribed thereon the name of the corporation and the word "Minnesota" and the words "Corporate Seal".

ARTICLE II.  
MEETINGS OF SHAREHOLDERS

Section 2.01. Place of Meetings. Meetings of the shareholders shall be held at the principal executive office of the corporation or at such other place as may be designated by the directors, except that any meeting called by or at the demand of a shareholder shall be held in the county in which the principal executive office of the corporation is located.

Section 2.02. Regular Meetings. A regular meeting of the shareholders shall be held on an annual basis on such date and at such time as the Board of Directors shall by resolution establish. At a regular meeting the shareholders shall elect qualified successors for directors whose terms have expired or are due to expire within six months after the date of the meeting and shall transact such other business as may properly come before them.

Section 2.03. Special Meetings. Special meetings of the shareholders may be held at any time and for any purpose and may be called by the chief executive officer, the chief financial officer, two or more directors or a shareholder or shareholders holding 10% or more of the voting power of all shares entitled to vote, except that a special meeting called by a shareholder or shareholders for the purpose of considering any action to directly or indirectly facilitate or effect a business combination, including any action to change or otherwise affect the composition of the Board of Directors for that purpose, must be called by a shareholder or shareholders holding 25% or more of the voting power of all shares entitled to vote. A shareholder or shareholders holding the requisite percentage of the voting power may demand a special meeting of the shareholders by written notice given to the chief executive officer or chief financial officer of the corporation stating the purposes of the meeting. Within 30 days after receipt of such a demand by one of those officers, the Board of Directors shall cause a special meeting of shareholders to be called and held on notice not later than 90 days after receipt of the demand, at the expense of the corporation. Special meetings shall be held on the date and at the time and place fixed by the chief executive officer, the chief financial officer or the Board of Directors, except that a special meeting called by or at demand of a shareholder or shareholders shall be held in the county where the principal executive office is located. The business transacted at a special meeting shall be limited to the purposes stated in the notice of the meeting.

Section 2.04. Quorum, Action by Shareholders. The holders of a majority of the shares entitled to vote shall constitute a quorum for the transaction of business at any regular or special meeting. All questions shall be decided by a majority vote of the number of shares entitled to vote and represented at the meeting at the time of the vote unless otherwise required by statute, the Articles of Incorporation, or these Bylaws.

Section 2.05. Adjourned Meetings. In case a quorum shall not be present at a meeting, those present may adjourn the meeting to such day as they shall, by majority vote, agree upon, and a notice of such adjournment and the date and time at which such meeting shall be reconvened shall be mailed to each shareholder entitled to vote at least 5 days before such adjourned meeting. If a quorum is present, a meeting may be adjourned from time to time without notice other than announcement at the meeting. At adjourned meetings at which a quorum is present, any business may be transacted which might have been transacted at the meeting as originally noticed. If a quorum is present, the shareholders may continue to transact business until adjournment notwithstanding the withdrawal of enough shareholders to leave less than a quorum.

Section 2.06. Voting. At each meeting of the shareholders every shareholder having the right to vote shall be entitled to vote either in person or by proxy. Each shareholder shall have one vote for each share having voting power registered in such shareholder's name on the books of the corporation. Jointly owned shares may be voted by any joint owner unless the corporation receives written notice from any one of them denying the authority of that person to vote the shares. Upon the demand of any shareholder, the vote upon any question before the meeting shall be by ballot.

Section 2.07. Closing of Books. The Board of Directors may fix a date not more than 60 days preceding the date of any meeting of shareholders, as the date (the "record date") for the determination of the shareholders entitled to notice of, and to vote at, such meeting. When a record date is so fixed, only shareholders as of that date are entitled to notice of and permitted to vote at that meeting of shareholders.

Section 2.08. Notice of Meetings. Except as otherwise specified in Section 2.05 or required by law, written notice of each meeting of the shareholders,

stating the date, time and place and, in the case of a special meeting, the purpose or purposes, shall be given at least ten days and not more than sixty days prior to the meeting to every holder of shares entitled to vote at such meeting. The business transacted at a special meeting of shareholders is limited to the purposes stated in the notice of the meeting.

Section 2.09. Waiver of Notice. Notice of any regular or special meeting may be waived by any shareholder either before, at or after such meeting orally or in a writing signed by such shareholder or a representative entitled to vote the shares of such shareholder. Attendance by a shareholder, at any meeting of shareholders, is a waiver of notice of such meeting, except where the shareholder objects at the beginning of the meeting to the transaction of business because the meeting is not lawfully called or convened or the item may not lawfully be considered at that meeting and the shareholder does not participate in the consideration of the item at that meeting.

### ARTICLE III. DIRECTORS

Section 3.01. General Powers. The business and affairs of the corporation shall be managed by or under the direction of the Board of Directors.

Section 3.02. Number, Qualification and Term of Office. The number of directors shall initially be ten and, thereafter, shall be fixed from time to time by the Board of Directors or by the affirmative vote of the holders of two-thirds of the voting power of the outstanding capital stock of the corporation, voting together as a single class. The directors shall be divided into three classes, as nearly equal in number as reasonably possible, with the term of office of the first class to expire at the 1988 annual meeting of shareholders, the term of office of the second class to expire at the 1989 annual meeting of shareholders and the term of office of the third class to expire at the 1990 annual meeting of shareholders. At each annual meeting of shareholders following such initial classification and election, directors elected to succeed those directors whose terms expire shall be elected for a term of office to expire at the third succeeding annual meeting of shareholders after their election.

Section 3.03. Board Meetings. Meetings of the Board of Directors may be held from time to time at such time and place as may be designated in the notice of such meeting.

Section 3.04. Calling Meetings; Notice. Meetings of the Board of Directors may be called by the chief executive officer by giving at least twenty-four hours' notice, or by any other director by giving at least five day's notice, of the date, time and place thereof to each director by mail, telephone, telegram or in person. If the day or date, time and place of a Board meeting have been announced at a previous meeting of the Board, no notice is required. Notice of an adjourned meeting need not be given other than by announcement at the meeting at which adjournment is taken of the date, time and place at which the meeting will be reconvened.

Section 3.05. Waiver of Notice. Notice of any meeting of the Board of Directors may be waived by any director either before, at, or after such meeting orally or in a writing signed by such director. A director, by his attendance at any meeting of the Board of Directors, shall be deemed to have waived notice of such meeting, except where the director objects at the beginning of the meeting to the transaction of business because the meeting is not lawfully called or convened and does not participate thereafter in the meeting.

Section 3.06. Quorum. A majority of the directors holding office immediately prior to a meeting of the Board of Directors shall constitute a quorum for the transaction of business at such meeting.

Section 3.07. Absent Directors. A director may give advance written consent or opposition to a proposal to be acted on at a meeting of the Board of Directors. If such director is not present at the meeting, consent or opposition to a proposal does not constitute presence for purposes of determining the existence of a quorum, but consent or opposition shall be counted as a vote in favor of or against the proposal and shall be entered in the minutes or other record of action at the meeting, if the proposal acted on at the meeting is substantially the same or has substantially the same effect as the proposal to which the director has consented or objected.

Section 3.08. Conference Communications. Any or all directors may participate in any meeting or conference of the Board of Directors, or of any duly constituted committee thereof, by any means of communication through which the directors may simultaneously hear each other during such meeting. For the purposes of establishing a quorum and taking any action, such directors participating pursuant to this Section 3.08 shall be deemed present in person at the meeting.

Section 3.09. Vacancies. Subject to the rights of the holders of any series of Preferred Stock then outstanding, newly created directorships resulting from any increase in the authorized number of directors or any vacancies in the Board of Directors resulting from death, resignation, retirement, disqualification, removal from office or other cause may be filled by a majority vote of the directors then in office though less than a quorum, and directors so chosen shall hold office for a term expiring at the next annual meeting of shareholders. No decrease in the number of directors constituting the Board of Directors shall shorten the term of any incumbent director.

Section 3.10. Removal. Any directors, or the entire Board of Directors, may be removed from office at any time, but only for cause and only by the affirmative vote of the holders of the proportion or number of the voting power of the shares of the classes or series the director represents sufficient to elect them.



Section 3.11. Committees. A resolution approved by the affirmative vote of a majority of the Board of Directors may establish committees having the authority of the Board in the management of the business of the corporation to the extent provided in the resolution. A committee shall consist of one or more persons, who need not be directors, appointed by affirmative vote of a majority of the directors present. Committees are subject to the direction and control of, and vacancies in the membership thereof shall be filled by, the Board of Directors, except as provided by Section 3.12 and by Minnesota Statutes Section 302A.243. A majority of the members of the committee holding office immediately prior to a meeting of the committee shall constitute a quorum for the transaction of business, unless a larger or smaller proportion or number is provided in the resolution establishing the committee.

Section 3.12. Committee of Disinterested Persons. Pursuant to the procedure set forth in Section 3.11, the Board may establish a committee composed of two or more disinterested directors or other disinterested persons to determine whether it is in the best interests of the corporation to pursue a particular legal right or remedy of the corporation and whether to cause the dismissal or discontinuance of a particular proceeding that seeks to assert a right or remedy on behalf of the corporation. The committee, once established, is not subject to the direction or control of, or termination by, the Board. A vacancy on the committee may be filled by a majority of the remaining committee members. The good faith determinations of the committee are binding upon the corporation and its directors, officers and shareholders. The committee terminates when it issues a written report of its determination to the Board.

Section 3.13. Written Action. Any action which might be taken at a meeting of the Board of Directors, or any duly constituted committee thereof, may be taken without a meeting if done in writing and signed by all of the directors or committee members, unless the Articles provide otherwise and the action need not be approved by the shareholders.

Section 3.14. Compensation. The Board may fix the compensation, if any, of directors.

Section 3.15. Nomination of Director Candidates. Nominations of candidates for election to the Board of Directors of the corporation at any annual meeting of the shareholders may be made only by or at the direction of the Board of Directors or by a shareholder entitled to vote at such annual meeting. All such nominations, except those made by or at the direction of the Board of Directors, shall be made pursuant to timely notice in writing to the secretary of the corporation. To be timely, any such notice must be received at the principal executive offices of the corporation not less than sixty days prior to the date of such annual meeting and must set forth (i) the name, age, business address and residence address and the principal occupation or employment of each nominee proposed in such notice, (ii) the name and address of the shareholder giving the notice as the same appears in the corporation's stock register, (iii) the number of shares of capital stock of the corporation which are beneficially owned by each such nominee and by such shareholder and (iv) such other information concerning each such nominee as would be required, under the rules of the Securities and Exchange Commission, in a proxy statement soliciting proxies for the election of such nominee. Such notice must also include a signed consent of each such nominee to serve as a director of the corporation, if elected. If the officer of the corporation presiding at an annual meeting of the shareholders determines that a director nomination was not made in accordance with the foregoing procedures, such nomination shall be void and shall be disregarded for all purposes.

#### ARTICLE IV. OFFICERS

Section 4.01. Number and Designation. The corporation shall have one or more natural persons exercising the functions of the offices of chief executive officer and chief financial officer. The Board of Directors may elect or appoint such other officers or agents as it deems necessary for the operation and management of the corporation, with such powers, rights, duties and responsibilities as may be determined by the Board, including, without limitation, a Chairman of the Board, a President, one or more Vice Presidents, a Secretary, a Treasurer, and such assistant officers or other officers as may from time to time, be elected or appointed by the Board. Each such officer shall have the powers, rights, duties and responsibilities set forth in these Bylaws unless otherwise determined by the Board. Any number of offices may be held by the same person.

Section 4.02. Chief Executive Officer. Either the Chairman of the Board, the President or another officer of the corporation may be designated from time to time by the Board to be the chief executive officer of the corporation. Unless provided otherwise by a resolution adopted by the Board of Directors, the chief executive officer (a) shall have general active management of the business of the corporation; (b), shall, when present, preside at all meetings of the shareholders; (c) shall see that all orders and resolutions of the Board are carried into effect; (d) shall sign and deliver in the name of the corporation any deeds, mortgages, bonds, contracts or other instruments pertaining to the business of the corporation, except in cases in which the authority to sign and deliver is required by law to be exercised by another person or is expressly delegated by these Bylaws or the Board to some other officer or agent of the corporation; (e) may maintain records of and certify proceedings of the Board and shareholders; and (f) shall perform such other duties as may from time to time be assigned to him by the Board.

Section 4.03. Chief Operating Officer. The chief operating officer (if one is elected by the Board) shall be either the President or a Vice President. He shall be responsible for the management of all of the operations of the corporation's business and shall have such other authority and duties as the Board of Directors or the chief executive officer from time to time may prescribe. He shall report to the chief executive officer and be responsible to

him. He may also execute and deliver in the name of the corporation any instruments or documents pertaining to the business of the corporation which could be executed by the chief executive officer.

Section 4.04. Chief Financial Officer. Unless provided otherwise by a resolution adopted by the Board of Directors, the chief financial officer (a) shall keep accurate financial records for the corporation; (b) shall deposit all monies, drafts and checks in the name of and to the credit of the corporation in such banks and depositories as the Board of Directors shall designate from time to time; (c) shall endorse for deposit all notes, checks and drafts received by the corporation as ordered by the Board, making proper vouchers therefor; (d) shall disburse corporate funds and issue checks and drafts in the name of the corporation, as ordered by the Board; (e) shall render to the chief executive officer and the Board of Directors, whenever requested, an account of all of his transactions as chief financial officer and of the financial condition of the corporation; and (f) shall perform such other duties as may be prescribed by the Board of Directors or the chief executive officer from time to time.

Section 4.05. Chairman of the Board. The Chairman of the Board, if one is elected, shall preside at all meetings of the directors and shall have such other duties as may be prescribed, from time to time, by the Board of Directors.

Section 4.06. President. Unless otherwise determined by the Board, the President shall be the chief executive officer of the corporation and shall supervise and control the business affairs of the corporation. If an officer other than the President is designated chief executive officer, the President shall perform such duties as may from time to time be assigned to him by the Board.

Section 4.07. Vice President. The Board of Directors may designate one or more Vice Presidents, who shall have such designations and powers and shall perform such duties as prescribed by the Board of Directors or by the President. In the event of the absence or disability of the President, Vice Presidents shall succeed to his power and duties in the order designated by the Board of Directors.

Section 4.08. Secretary. The Secretary shall be secretary of and shall attend all meetings of the shareholders and Board of Directors and shall record all proceedings of such meetings in the minute book of the corporation. Except as otherwise required or permitted by statute or by these Bylaws, the Secretary shall give notice of meetings of shareholders and directors. The Secretary shall perform such other duties as may, from time to time, be prescribed by the Board of Directors or by the chief executive officer.

Section 4.09. Treasurer. Unless otherwise determined by the Board, the Treasurer shall be the Chief Financial Officer of the Corporation. If an officer other than the Treasurer is designated Chief Financial Officer, the Treasurer shall perform such duties as may from time to time be assigned to him by the Board.

Section 4.10. Authority and Duties. In addition to the foregoing authority and duties, all officers of the corporation shall respectively have such authority and perform such duties in the management of the business of the corporation as may be determined from time to time by the Board of Directors. Unless prohibited by a resolution of the Board of Directors, an officer elected or appointed by the Board may, without specific approval of the Board, delegate some or all of the duties and powers of an office to other persons.

Section 4.11. Removal and Vacancies. Any officer may be removed from his office by the Board of Directors at any time, with or without cause. Such removal, however, shall be without prejudice to the contract rights of the person so removed. If there be a vacancy among the officers of the corporation by reason of death, resignation or otherwise, such vacancy shall be filled for the unexpired term by the Board of Directors.

Section 4.12. Compensation. The officers of this corporation shall receive such compensation for their services as may be determined by or in accordance with resolutions of the Board of Directors.

#### ARTICLE V. SHARES AND THEIR TRANSFER

Section 5.01. Certificates for Shares. All shares of the corporation shall be certificated shares. Every owner of shares of the corporation shall be entitled to a certificate, to be in such form as shall be prescribed by the Board of Directors, certifying the number of shares of the corporation owned by such shareholder. The certificates for such shares shall be numbered in the order in which they shall be issued and shall be signed, in the name of the corporation, by the President or any Vice President and by the Secretary or an Assistant Secretary or by such officers as the Board of Directors may designate. If the certificate is signed by a transfer agent or registrar, such signatures of the corporate officers may be facsimiles, engraved or printed. Every certificate surrendered to the corporation for exchange or transfer shall be canceled, and no new certificate or certificates shall be issued in exchange for any existing certificate until such existing certificate shall have been so canceled, except in cases provided for in Section 5.03.

Section 5.02. Transfer of Shares. Transfer of shares on the books of the corporation may be authorized only by the shareholder named in the certificate, or the shareholder's legal representative, or the shareholder's duly authorized attorney-in-fact, and upon surrender of the certificate or the certificates for such shares. The corporation may treat as the absolute owner of shares of the corporation, the person or persons in whose name shares are registered on the books of the corporation. The Board of Directors may appoint one or more transfer agents and registrars to maintain the share records of the corporation and to effect share transfers on its behalf.

Section 5.03. Loss of Certificates. Any shareholder claiming a certificate for shares to be lost, stolen or destroyed shall make an affidavit of that fact in such form as the Board of Directors shall require and shall, if the Board of Directors so requires, give the corporation a bond of indemnity in form, in an amount, and with one or more sureties satisfactory to the Board of Directors, to indemnify the corporation against any claim which may be made against it on account of the reissue of such certificate, whereupon a new certificate may be issued in the same tenor and for the same number of shares as the one alleged to have been lost, stolen or destroyed.

ARTICLE VI.  
DIVIDENDS, RECORD DATE

Section 6.01. Dividends. The Board of Directors shall have the authority to declare dividends and other distributions upon shares to the extent permitted by law.

Section 6.02. Record Date. The Board of Directors may fix a date not exceeding 60 days preceding the date fixed for the payment of any dividend as the record date for the determination of the shareholders entitled to receive payment of the dividend and, in such case, only shareholders of record on the date so fixed shall be entitled to receive payment of such dividend.

ARTICLE VII.  
SECURITIES OF OTHER CORPORATIONS.

Section 7.01. Voting Securities Held by the Corporation. The chief executive officer shall have full power and authority on behalf of the corporation (a) to attend any meeting of security holders of other corporations in which the corporation may hold securities and to vote such securities on behalf of this corporation; (b) to execute any proxy for such meeting on behalf of the corporation; or (c) to execute a written action in lieu of a meeting of such other corporation on behalf of this corporation. At such meeting, the chief executive officer shall possess and may exercise any and all rights and powers incident to the ownership of such securities that the corporation possesses. The Board of Directors or the chief executive officer may, from time to time, confer or delegate such powers to one or more other persons.

Section 7.02. Purchase and Sale of Securities. The chief executive officer shall have full power and authority on behalf of the corporation to purchase, sell, transfer or encumber any and all securities of any other corporation owned by the corporation, and may execute and deliver such documents as may be necessary to effectuate such purchase, sale, transfer or encumbrance. The Board of Directors or the chief executive officer may, from time to time, confer or delegate such powers to one or more other persons.

ARTICLE VIII.  
INDEMNIFICATION OF CERTAIN PERSONS

Section 8.01. The corporation shall indemnify officers and directors, for such expenses and liabilities, in such manner, under such circumstances, and to such extent as permitted by Minnesota Statutes Section 302A.521, as now enacted or hereafter amended.

ARTICLE IX.  
AMENDMENTS

Section 9.01. These Bylaws may be amended or altered by the Board of Directors at any meeting if notice of such proposed amendment shall have been given in the notice of such meeting. Such authority in the Board of Directors is subject to (a) the limitations imposed by Minnesota Statutes Section 302A.181, as now enacted or hereafter amended, or other applicable law and (b) the power of the shareholders to change or repeal such Bylaws by a majority vote of the shareholders present or represented at any meeting of shareholders called for such purpose.

SEVENTH AMENDMENT TO CREDIT AGREEMENT

THIS SEVENTH AMENDMENT (this "Amendment") dated as of May 27, 1997, amends and modifies that certain Credit Agreement, dated as of October 1, 1990, as amended pursuant to Amendments dated as of June 12, 1992, December 31, 1992, November 8, 1993, February 8, 1994, April 10, 1995, and September 27, 1996 (as so amended, the "Credit Agreement"), between GRACO INC., a Minnesota corporation (the "Company") and FIRST BANK NATIONAL ASSOCIATION (the "Bank"). Terms not otherwise expressly defined herein shall have the meanings set forth in the Credit Agreement.

FOR VALUE RECEIVED, the Company and the Bank agree that the Credit Agreement is amended as follows:

ARTICLE I - AMENDMENTS TO THE CREDIT AGREEMENT

1.1 Defined Terms. Section 1.01 is amended as follows:

(a) The definition of "Maturity Date" is amended to read as follows:

"`Maturity Date': June 29, 1998."

1.2 Note. The Loans shall continue to be evidenced by the Note date April 10, 1995 in the principal amount of \$25,000,000.

ARTICLE II - REPRESENTATIONS AND WARRANTIES

To induce the Bank to enter into this Amendment and to make and maintain the Loans under the Credit Agreement as amended hereby, the Company hereby warrants and represents to the Bank that it is duly authorized to execute and deliver this Amendment, and to perform its obligations under the Credit Agreement as amended hereby, and that this Amendment constitutes the legal, valid and binding obligation of the Company, enforceable in accordance with its terms.

ARTICLE II - CONDITIONS PRECEDENT

This Agreement shall become effective on the date first set forth above, provided, however, that the effectiveness of this Amendment is subject to the satisfaction of each of the following conditions precedent:

2.1 Warranties. Before and after giving effect to this Amendment, the representations and warranties in Section 6 of the Credit Agreement shall be true and correct as thought made on the date hereof, except for changes that are permitted by the terms of the Credit Agreement. The execution by the Company of this Agreement shall be deemed a representation that the Company has complied with the foregoing condition.

2.2 Defaults. Before and after giving effect to this Amendment, no Event of Default and no Unmarred Event of Default shall have occurred and be continuing under the Credit Agreement. The execution by the Company of this Agreement shall be deemed a representation that the Company has complied with the foregoing condition.

2.3 Documents. The Company shall have delivered this Amendment and certified copies of resolutions of the Board of Directors of the Company authorizing or ratifying the execution, delivery and performance, respectively, of this Amendment, together with an incumbency certificate of officers executing this Amendment.

ARTICLE III - GENERAL

3.1 Expenses. The Company agrees to reimburse the Bank upon demand for all reasonable expenses, including reasonable fees of attorneys (who may be employees of the Bank) and legal expenses incurred by the Bank in the preparation, negotiation and execution of this Amendment and any other document required to be furnished herewith, and in enforcing the obligations of the Company hereunder, and to pay and save the Bank harmless from all liability for, any taxes which may be payable with respect to the execution or delivery of this Agreement, which obligations of the Company shall survive any termination of the Credit Agreement.

3.2 Counterparts. This Agreement may be executed in as many counterparts as may be deemed necessary or convenient, and by the different parties hereto on separate counterparts, each of which, when so executed, shall be deemed an original but all such counterparts shall constitute but one and the same instrument.

3.3 Severability. Any provision of this Amendment which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition of unenforceability without invalidating the remaining portions hereof or affecting the validity or enforceability of such provisions in any other jurisdiction.

3.4 Law. This Amendment shall be a contract made under the laws of the State of Minnesota, which laws shall govern all the rights and duties hereunder.

3.5 Successors; Enforceability. This Amendment shall be binding upon the Company and the Bank and their respective successors and assigns, and shall inure to the benefit of the Company and the Bank and the successors and assigns of the Bank. Except as hereby amended, the Credit Agreement shall remain in full force and effect and is hereby ratified and confirmed in all respects.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be executed at Minneapolis, Minnesota by their respective officers thereunto duly

authorized as of the date first written above.

GRACO INC.

By: /s/ Mark W. Sheahan

Title: Treasurer

FIRST BANK NATIONAL ASSOCIATION

By: /s/ Michael S. Harter

Title: Commercial Banking Officer

GRACO INC. KEY EMPLOYEE AGREEMENT

AGREEMENT, by and between Graco Inc., a Minnesota corporation (the "Company") and \_\_\_\_\_ (the "Executive"), dated as of the \_\_\_\_\_ day of \_\_\_\_\_, \_\_\_\_\_.

The Board of Directors of the Company (the "Board"), has determined that it is in the best interests of the Company and its shareholders to assure that the Company will have the continued dedication of the Executive, notwithstanding the possibility, threat or occurrence of a Change of Control (as defined in Section 2 below) of the Company. The Board believes it is imperative to diminish the inevitable distraction of the Executive by virtue of the personal uncertainties and risks created by a pending or threatened Change of Control, to encourage the Executive's full attention and dedication to the Company currently and in the event of any threatened or pending Change of Control, to provide inducement for the Executive to remain an employee of the Company in the event of any threatened or pending Change of Control, and to facilitate an orderly transition in the event of a Change of Control. Therefore, in order to accomplish these objectives, the Board has caused the Company to enter into this Agreement.

NOW, THEREFORE, IT IS HEREBY AGREED AS FOLLOWS:

1. Certain Definitions: "Effective Date;" "Change of Control Period;" "Company;" "Affiliated Companies."

- (a) The "Effective Date" shall mean the first date during the Change of Control Period (as defined in Section 1(b)) on which a Change of Control (as defined in Section 2) occurs. Anything in this Agreement to the contrary notwithstanding, if a Change of Control occurs and if the Executive's employment with the Company is terminated prior to the date on which the Change of Control occurs, and if it is reasonably demonstrated by the Executive that such termination of employment (i) was at the request of a third party who has taken steps reasonably calculated to effect the Change of Control or (ii) otherwise arose in connection with or anticipation of the Change of Control, then for all purposes of this Agreement the "Effective Date" shall mean the date immediately prior to the date of such termination of employment.
- (b) The "Change of Control Period" shall mean the period commencing on the date hereof and ending on the second anniversary of such date, provided, however, that commencing on the date one year after the date hereof, and on each annual anniversary of such date (such date and each annual anniversary thereof shall be hereinafter referred to as the "Renewal Date"), the Change of Control Period shall be automatically extended so as to terminate two years from such Renewal Date, unless at least 60 days prior to the Renewal Date the Company shall give notice to the Executive that the Change of Control Period shall not be so extended.
- (c) The "Company" shall mean the Company as hereinbefore defined and any successor to its business and/or assets which assumes or agrees to perform this Agreement by operation of law or otherwise.
- (d) As used in this Agreement, the term "affiliated companies" shall include any company controlled by, controlling or under common control with the Company.

2. Change of Control. For the purpose of this Agreement

(a) A "Change of Control" means:

- (i) acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act of 1934), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 under the 1934 Act) which results in the beneficial ownership by such Person of 25% or more of either
  - A. the then outstanding shares of Common Stock of the Company (the "Outstanding Company Common Stock") or
  - B. the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities"); provided, however, that the following acquisitions will not result in a Change of Control:
    - (1) an acquisition directly from the Company,
    - (2) an acquisition by the Company,
    - (3) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
    - (4) an acquisition by any Person who is deemed to have beneficial ownership of the Company common stock or other Company voting securities owned immediately after said acquisition by the Trust Under the Will of Clarissa L. Gray ("Trust Person"), provided that such acquisition does not result in the beneficial ownership by such Person of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, and provided further that for purposes of

this Section 2, a Trust Person shall not be deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by The Graco Foundation or any employee benefit plan of the Company, including without limitation the Graco Employee Retirement Plan and the Graco Employee Stock Ownership Plan,

(5) an acquisition by the Executive or any group that includes the Executive, or

(6) an acquisition by any corporation pursuant to a transaction that complies with clauses (A), (B) and (C) of Section 2 (a)(iii) below; and provided, further, that if any Person's beneficial ownership of the Outstanding Company Common Stock or Outstanding Company Voting Securities is 25% or more as a result of a transaction described in clause (1) or (2) above, and such Person subsequently acquires beneficial ownership of additional Outstanding Company Common Stock or Outstanding Company Voting Securities as a result of a transaction other than that described in clause (1) or (2) above, such subsequent acquisition will be treated as an acquisition that causes such Person to own 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities and be deemed a Change of Control; and provided further, that in the event any acquisition or other transaction occurs which results in the beneficial ownership of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities by any Trust Person, the Incumbent Board may by majority vote increase the threshold beneficial ownership percentage to a percentage above 32% for any Trust Person; or

(ii) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board, or

(iii) The approval by the shareholders of the Company of a reorganization, merger, consolidation or statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination") or, if consummation of such Business Combination is subject, at the time of such approval by stockholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation); excluding, however, such a Business Combination pursuant to which

A. all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,

B. no Person [excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination] beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and

C. at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

(v) approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.

3. Employment Period. For purposes of this Agreement, the term "Employment Period" shall mean the period commencing on the Effective Date and ending on the earlier of (i) the termination by the Company or the Executive of the Executive's employment with the Company, or (ii) the second anniversary of the Effective Date." As provided in Section 10(f), nothing stated in this Agreement shall restrict the right of the Company or the Executive at any time to terminate the Executive's employment with the Company, subject to the obligations of the Company provided for in this Agreement in the event of such termination.

4. Terms of Employment.

(a) Position and Duties.

(i) During the Employment Period, (A) the Executive's position (including offices and titles), duties and responsibilities shall be at least commensurate in all material respects with the most significant of those held, exercised and assigned at any time during the 90-day period immediately preceding the Effective Date and (B) the Executive's services shall be performed at the location where the Executive was employed immediately preceding the Effective Date or any office or location less than 50 miles from such location.

(ii) Except as otherwise expressly provided in this Agreement, during the Employment Period, and excluding any periods of vacation and sick leave to which the Executive is entitled, the Executive agrees to devote reasonable attention and time during normal business hours to the business and affairs of the Company. During the Employment Period it shall not be a violation of this Agreement for the Executive to (A) serve on corporate, civic or charitable boards or committees, (B) deliver lectures, fulfill speaking engagements or teach at educational institutions and (C) manage personal investments, so long as such activities do not significantly interfere with the performance of the Executive's responsibilities as an employee of the Company in accordance with this Agreement. To the extent that any such activities have been conducted by the Executive prior to the Effective Date, the continued conduct of such activities (or the conduct of activities similar in nature and scope thereto) subsequent to the Effective Date shall not thereafter be deemed to interfere with the performance of the Executive's responsibilities to the Company.

(b) Compensation.

(i) Base Salary. During the Employment Period, the Executive shall receive an annual base salary ("Annual Base Salary") which shall be paid at a monthly rate, at least equal to twelve times the highest monthly base salary paid or payable to the Executive by the Company and its affiliated companies in respect of the twelve-month period immediately preceding the month in which the Effective Date occurs. During the Employment Period, the Annual Base Salary shall be reviewed at least annually and shall be increased at any time and from time to time as shall be substantially consistent with increases in base salary generally awarded in the ordinary course of business to other peer executives of the Company. The term Annual Base Salary as used in this Agreement shall refer to Annual Base Salary as so increased. The Executive's Annual Base Salary shall not be reduced after any such increase. Any increase in Annual Base Salary shall not serve to limit or reduce any other obligation to the Executive under this Agreement.

(ii) Annual Incentive Payments. In addition to Annual Base Salary, the Executive shall be awarded, for each fiscal year during the Employment Period, an annual bonus ("Annual Bonus") in cash, in accordance with the Company's Annual Bonus Plan, or other plan instituted in lieu of the Annual Bonus Plan which provides for an annual incentive payment in addition to Annual Base Salary ("Substitute Plan"). The Executive shall participate in the Annual Bonus Plan or Substitute Plan at the same level at which the Executive participated immediately prior to the Effective Date, or if more favorable, at the level of other peer executives of the Company and its affiliated companies. Any Substitute Plan instituted by the Company after the Effective Date shall be at least as favorable, in the aggregate, as the most favorable Annual Bonus Plan or Substitute Plan in effect at any time during the 90-day period immediately preceding the Effective Date.

(iii) Savings and Retirement Plans. During the Employment Period, the Executive shall be entitled to participate in all savings and retirement plans, practices, policies and programs applicable generally to other peer executives of the Company and its affiliated companies, but in no event shall such plans, practices, policies and programs provide the Executive with savings opportunities and retirement benefit opportunities, in each case, less favorable, in the aggregate, than the most favorable of those provided by the Company and its affiliated companies for the Executive under such plans, practices, policies and programs as in effect at anytime during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, those provided generally at any time after the Effective Date to other peer executives of the Company and its affiliated companies.



- (iv) Welfare Benefit Plans. During the Employment Period, the Executive and/or the Executive's family, as the case maybe, shall be eligible for participation in and shall receive all benefits under welfare benefit plans, practices, policies and programs provided by the Company and its affiliated companies (including, without limitation, medical, prescription, dental, disability, salary continuance, employee life, group life, accidental death and travel accident insurance plans and programs) to the extent applicable generally to other peer executives of the Company and its affiliated companies, but in no event shall such plans, practices, policies and programs provide the Executive with benefits which are less favorable,, in the aggregate, than the most favorable of such plans, practices, policies and programs in effect for the Executive at anytime during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, those provided generally at any time after the Effective Date to other peer executives of the Company and its affiliated companies.
- (v) Expenses. During the Employment Period, the Executive shall be entitled to receive prompt reimbursement for all reasonable expenses incurred by the Executive in accordance with the most favorable policies, practices and procedures of the Company and its affiliated companies in effect for the Executive at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, as in effect generally at any time thereafter with respect to other peer executives of the Company and its affiliated companies.
- (vi) Perquisites. During the Employment Period, the Executive shall be entitled to perquisites in accordance with the most favorable plans, practices, programs and policies of the Company and its affiliated companies in effect for the Executive at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, as in effect generally at any time thereafter with respect to other peer executives of the Company and its affiliated companies.
- (vii) Office and Support Staff. During the Employment Period, the Executive shall be entitled to an office or offices of a size and with furnishings and other appointments, and to secretarial and other assistance, at least equal to the most favorable of the foregoing provided to the Executive by the Company at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, as provided generally at any time thereafter with respect to other peer executives of the Company.
- (viii) Vacation. During the Employment Period, the Executive shall be entitled to paid vacations in accordance with the most favorable plans, policies, programs and practices of the Company and its affiliated companies as in effect for the Executive at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, as in effect generally at any time thereafter with respect to other peer Executives of the Company and its affiliated companies.

## 5. Termination of Employment.

- (a) Death or Disability. The Executive's employment shall terminate automatically upon the Executive's death during the Employment Period. If the Company determines in good faith that the Disability of the Executive has occurred during the Employment Period (pursuant to the definition of Disability set forth below), it may give to the Executive written notice in accordance with Section 10(b) of this Agreement of its intention to terminate the Executive's employment. In such event, the Executive's employment with the Company shall terminate effective on the 30th day after receipt of such notice by the Executive (the "Disability Effective Date"), provided that, within the 30 days after such receipt, the Executive shall not have returned to full-time performance of the Executive's duties. For purposes of this Agreement, "Disability" shall mean the absence of the Executive from the Executive's duties with the Company on a full-time basis for 180 consecutive days as a result of incapacity due to mental or physical illness which is determined to be total and permanent by a physician selected by the Company or its insurers and acceptable to the Executive or the Executive's legal representative (such agreement as to acceptability not to be withheld unreasonably).
- (b) Cause. The Company may terminate the Executive's employment during the Employment Period for Cause. For purposes of this Agreement, "Cause" shall mean (i) repeated violations by the Executive of the Executive's obligations under Section 4(a) of this Agreement (other than as a result of incapacity due to physical or mental illness) which are demonstrably willful and deliberate on the Executive's part, which are committed in bad faith or without the belief on the part of the Executive that such violations are in the best interests of the Company and which are not remedied in a reasonable period of time after receipt of written notice from the Company specifying such violations or (ii) the conviction of the Executive of a felony involving moral turpitude.
- (c) Good Reason. The Executive's employment may be terminated by the Executive for Good Reason. For purposes of this Agreement, "Good Reason" shall mean:
  - (i) the assignment to the Executive of any duties materially

inconsistent in any respect with the Executive's position (including offices and titles), duties or responsibilities as contemplated by Section 4(a) of this Agreement, or any other action by the Company which results in a material diminution in such position, duties or responsibilities, excluding for this purpose an isolated, insubstantial and inadvertent action not taken in bad faith and which is remedied by the Company promptly after receipt of notice thereof given by the Executive;

- (ii) any failure by the Company to comply with any of the provisions of Section 4(b) of this Agreement, other than an isolated, insubstantial and inadvertent failure not occurring in bad faith and which is remedied by the Company promptly after receipt of notice thereof given by the Executive;
- (iii) the Company's requiring the Executive to be based at any office or location other than that described in Section 4(a)(i)(B) hereof or the Company's requiring the Executive to travel on Company business to a substantially greater extent than required immediately prior to the Effective Date;
- (iv) any purported termination by the Company of the Executive's employment otherwise than as expressly permitted by this Agreement; or
- (v) any failure by the Company to comply with and satisfy Section 9(c) of this Agreement.

For purposes of this Section 5(c), any good faith determination of "Good Reason" made by the Executive shall be conclusive.

- (d) Notice of Termination. Any termination by the Company for Cause, or by the Executive for Good Reason, shall be communicated by Notice of Termination to the other party hereto given in accordance with Section 10(b) of this Agreement. For purposes of this Agreement, a "Notice of Termination" means a written notice which (i) indicates the specific termination provision in this Agreement relied upon, (ii) to the extent applicable, sets forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of the Executive's employment under the provision so indicated and (iii) if the Date of Termination (as defined below) is other than the date of receipt of such notice, specifies the termination date (which date shall be not more than fifteen days after the giving of such notice). The failure by the Executive or the Company to set forth in the Notice of Termination any fact or circumstance which contributes to a showing of Good Reason or Cause shall not waive any right of the Executive or the Company hereunder or preclude the Executive or the Company from asserting such fact or circumstance in enforcing the Executive's or the Company's rights hereunder.
- (e) Date of Termination. "Date of Termination" means (i) if the Executive's employment is terminated by the Company for Cause, or by the Executive for Good Reason, the date of receipt of the Notice of Termination or any later date specified therein, as the case may be, (ii) if the Executive's employment is terminated by the Company other than for Cause or Disability or death, the Date of Termination shall be the date on which the Company notifies the Executive of such termination and (iii) if the Executive's employment is terminated by reason of death or Disability, the Date of Termination shall be the date of death of the Executive or the Disability Effective Date, as the case may be.

## 6. Obligations of the Company upon Termination.

- (a) Good Reason; Other Than for Cause, Death or Disability. If, within two years after the Effective Date, the Company shall terminate the Executive's employment other than for Cause, death or Disability, or the Executive shall terminate employment for Good Reason, in lieu of further payments pursuant to Section 4(b) with respect to periods following the Date of Termination:
  - (i) except as provided in Section 6(e) below, the Company shall pay to the Executive, in a lump sum in cash, within 30 days (except as provided in subsection 6(a)(i)A below) after the Date of Termination, the aggregate of the following amounts (such aggregate shall be hereinafter referred to as the "Special Termination Amount"):
    - A. the sum of (1) the Executive's Annual Base Salary through the Date of Termination to the extent not theretofore paid, and, (2) the product of (x) the higher of (I) the midpoint between the minimum and the maximum bonus payment under the Annual Bonus Plan or Substitute Plan applicable to the Executive for the fiscal year in which the Date of Termination occurs, or (II) the amount that would be payable to the Executive for the fiscal year in which the Date of Termination occurs under the Annual Bonus Plan or Substitute Plan had the termination not so occurred (which amount shall be payable pursuant to this clause 2 within 30 days after it is calculated), and (y) a fraction, the numerator of which is the number of days in the current fiscal year through the Date of Termination, and the denominator of which is 365 (the sum of the amounts described in clauses (1) and (2) shall be hereinafter referred to as the "Accrued Obligations"); and
    - B. the amount equal to the product of (1) two and (2) the sum

of (x) the Executive's Annual Base Salary and (y) the midpoint between the maximum and minimum bonus payment applicable to the Executive for the fiscal year in which the Date of Termination occurs under the Annual Bonus Plan or Substitute Plan; and

- (ii) for two years following the Date of Termination or such longer period as any plan, program, practice or policy may provide, the Company shall continue benefits to the Executive and/or the Executive's family at least equal to those which would have been provided to them in accordance with the plans programs, practices and policies described in Section 4(b)(iv) of this Agreement if the Executive's employment had not been terminated, in accordance with the most favorable plans, practices, programs or policies of the Company and its affiliated companies applicable generally to other peer executives and their families during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, as in effect generally at any time thereafter with respect to other peer executives of the Company and its affiliated companies and their families, provided, however, that if the Executive becomes re-employed with another employer and is eligible to receive medical or disability welfare benefits under another employer provided plan, the medical and disability welfare benefits described herein shall cease upon the Executive and the Executive's family becoming eligible under such other plan. For purposes of determining eligibility of the Executive for retiree benefits pursuant to such plans, practices, programs and policies, the Executive shall be considered to have remained employed until two years after the Date of Termination and to have retired two years after the Date of Termination.
- (b) Death. If the Executive's employment is terminated by reason of the Executive's death within two years after the Effective Date, this Agreement shall terminate without further obligations to the Executive's legal representatives under this Agreement, other than for payment of the Accrued Obligations. The Accrued Obligations shall be paid to the Executive's estate or beneficiary, as applicable, in a lump sum in cash within 30 days of the Date of Termination, or as otherwise provided in Section 6(a)(i)(A). In addition, the Executive's family shall be entitled to receive benefits at least equal to the most favorable benefits provided by the Company and any of its affiliated companies to surviving families of deceased peer executives of the Company and such affiliated companies under such plans, programs, practices and policies relating to family death benefits, if any, as in effect with respect to other deceased peer executives and their families at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive and/or the Executive's family, as in effect on the date of the Executive's death with respect to other deceased peer executives of the Company and its affiliated companies and their families.
- (c) Disability. If the Executive's employment is terminated by reason of the Executive's Disability within two years after the Effective Date, this Agreement shall terminate without further obligations to the Executive, other than for payment of the Accrued Obligations. The Accrued Obligations shall be paid to the Executive in a lump sum in cash within 30 days of the Date of Termination or as otherwise provided in Section 6(a)(i)(A). In addition, the Executive shall be entitled after the Disability Effective Date to receive disability and other benefits at least equal to the most favorable of those generally provided by the Company and its affiliated companies to disabled executives and/or their families in accordance with such plans, programs, practices, and policies relating to disability, if any, as in effect generally with respect to other disabled peer executives and their families at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive and/or the Executive's family, as in effect at any time thereafter generally with respect to other disabled peer executives of the Company and its affiliated companies and their families.
- (d) Cause; Other than for Good Reason. If the Executive's employment shall be terminated for Cause within two years after the Effective Date, this Agreement shall terminate without further obligations to the Executive other than the obligation to pay to the Executive Annual Base Salary through the Date of Termination plus the amount of any compensation previously deferred by the Executive, in each case to the extent theretofore unpaid. If the Executive voluntarily terminates employment within two years after the Effective Date, excluding a termination for Good Reason, this Agreement shall terminate without further obligations to the Executive, other than Annual Base Salary through the Date of Termination plus the amount of any compensation previously deferred by the Executive, in each case to the extent theretofore unpaid, and any payment that may be due under the terms of the Annual Bonus Plan or any Successor Plan. In such case, all such amounts shall be paid to the Executive in a lump sum in cash within 30 days of the Date of Termination or, in the case of any payment under the Annual Bonus Plan or any Successor Plan, pursuant to the terms thereof.
- (e) Possible Payment Reduction. Notwithstanding any provision to the contrary contained in this Agreement, if the lump sum cash payment due and the other benefits to which the Executive shall become entitled under Section 6(a) hereof, either alone or together with other payments in the nature of compensation to the Executive which are contingent on a change in the ownership or effective control of the Company or in the ownership of a substantial portion of the assets of the Company or otherwise, would constitute a "parachute payment" as

defined in Section 280G of the Internal Revenue Code of 1986, as amended (the "Code") or any successor provision thereto, such lump sum payment and/or such other benefits and payments shall be reduced (but not below zero) to the largest aggregate amount as will result in no portion thereof being subject to the excise tax imposed under Section 4999 of the Code (or any successor provision thereto) or being non-deductible to the Company for Federal Income Tax purposes pursuant to Section 280G of the Code (or any successor provision thereto). The Executive in good faith shall determine the amount of any reduction to be made pursuant to this Section 6(e) and shall select from among the foregoing benefits and payments those which shall be reduced. No modification of, or successor provision to, Section 280G or Section 4999 subsequent to the date of this Agreement shall, however, reduce the benefits to which the Executive would be entitled under this Agreement in the absence of this Section 6(e) to a greater extent than they would have been reduced if Section 280G and Section 4999 had not been modified or superseded subsequent to the date of this Agreement, notwithstanding anything to the contrary provided in the first sentence of this Section 6(e).

7. Non-exclusivity of Rights. Nothing in this Agreement shall prevent or limit the Executive's continuing or future participation in any plan, program, policy or practice provided by the Company or any of its affiliated companies and for which the Executive may qualify, nor shall anything herein limit or otherwise affect such rights as the Executive may have under any contract or agreement with the Company or any of its affiliated companies. Amounts which are vested benefits or which the Executive is otherwise entitled to receive under any plan, policy, practice or program of or not the Executive obtains other employment. The Company agrees to pay, to the full extent permitted by law, all legal fees and expenses which the Executive may reasonably incur as a result of any contest (regardless of the outcome thereof) by the Company, the Executive or others of the validity or enforceability of, or liability under, any provision of this Agreement or any guarantee of performance thereof (including as a result of any contest by the Executive about the amount of any payment pursuant to this Agreement), plus in each case interest on any delayed payment at the applicable Federal rate provided for in Section 7872(f)(2)(A) of the Internal Revenue Code of 1986, as amended (the "Code").

8. Full Settlement; No Mitigation; Legal Fees. The Company's obligation to make the payments provided for in this Agreement and otherwise to perform its obligations hereunder shall not be affected by any set-off, counterclaim, recoupment, defense or other claim, right or action which the Company may have against the Executive or others. In no event shall the Executive be obligated to seek other employment or take any other action by way of mitigation of the amounts payable to the Executive under any of the provisions of this Agreement and such amounts shall not be reduced whether or not the Executive obtains other employment. The Company agrees to pay, to the full extent permitted by law, all legal fees and expenses which the Executive may reasonably incur as a result of any contest (regardless of the outcome thereof) by the Company, the Executive or others of the validity or enforceability of, or liability under, any provision of this Agreement or any guarantee of performance thereof (including as a result of any contest by the Executive about the amount of any payment pursuant to this Agreement), plus in each case interest on any delayed payment at the applicable Federal rate provided for in Section 7872(f)(2)(A) of the Internal Revenue Code of 1986, as amended (the "Code").

9. Successors.

- (a) This Agreement is personal to the Executive and without the prior written consent of the Company shall not be assignable by the Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by the Executive's legal representatives.
- (b) This Agreement shall inure to the benefit of and be binding upon the Company and its successors and assigns.
- (c) The Company will require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Company to assume expressly and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it if no such succession had taken place.

10. Miscellaneous.

- (a) This Agreement shall be governed by and construed in accordance with the laws of the State of Minnesota, without reference to principles of conflict of laws. The captions of this Agreement are not part of the provisions hereof and shall have no force or effect. This Agreement may not be amended or modified otherwise than by a written agreement executed by the parties hereto or their respective successors and legal representatives.
- (b) All notices and other communications hereunder shall be in writing and shall be given by hand delivery to the other party or by registered or certified mail, return receipt requested, postage prepaid, addressed as follows:

If to the Executive:  
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If to the Company:  
  
Graco Inc.  
4050 Olson Memorial Highway

or to such other address as either party shall have furnished to the other in writing in accordance herewith. Notice and communications shall be effective when actually received by the addressee.

- (c) The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision of this Agreement.
- (d) The Company may withhold from any amounts payable under this Agreement such Federal, state or local taxes as shall be required to be withheld pursuant to any applicable law or regulation.
- (e) The Executive's or the Company's failure to insist upon strict compliance with any provision hereof or any other provision of this Agreement or the failure to assert any right the Executive or the Company may have hereunder, including, without limitation, the right of the Executive to terminate employment for Good Reason pursuant to Section 5(c)(i)(v) of this Agreement, shall not be deemed to be a waiver of such provision or right or any other provision or right of this Agreement.
- (f) The Executive and the Company acknowledge that, except as may otherwise be provided under any other written agreement between the Executive and the Company, the employment of the Executive by the Company may be terminated by either the Executive or the Company at any time prior to the Effective Date or, subject to the obligations of the Company provided for in this Agreement in the event of a termination after the Effective Date, at anytime on or after the Effective Date. Moreover, if prior to the Effective Date, the Executive's employment with the Company terminates, then the Executive shall have no further rights under this Agreement. From and after the Effective Date, this Agreement shall supersede any other agreement between the parties with respect to the subject matter hereof.

IN WITNESS WHEREOF, the Executive has hereunto set the Executive's hand and, pursuant to the authorization from its Board of Directors, the Company has caused these presents to be executed in its name on its behalf, all as of the day and year first above written.

Executive

Graco Inc.

By

-----  
Name

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Name and title

FIRST AMENDMENT  
OF  
GRACO INC.  
DEFERRED COMPENSATION PLAN RESTATED

The Graco Inc. Deferred Compensation Plan Restated ("Plan"), which was adopted and approved by the Board of Directors of Graco Inc. effective December 1, 1992, is hereby amended as follows:

1. AMENDMENT. Effective September 1, 1996, Section 2.1 of the Plan is amended to read in full as follows:

2.1. Participation by Eligible Employees. Each employee that is classified in a salary grade level identified in Appendix B shall be eligible to become a Participant in this Plan as follows:

(a) Any eligible employee who is employed on the Effective Date of the Plan shall become a Participant within thirty-one days after the Effective Date if the eligible employee enters into a Salary Reduction Agreement with the Employer during July or August, 1988 to be effective September 1, 1988, which provides for salary deferrals under the Plan.

(b) Thereafter, an eligible employee shall become a Participant if, during the Annual Enrollment Period, such Participant enters into a Salary Reduction Agreement with the Employer which provides for salary deferrals under the Plan. The Annual Enrollment period shall occur during the month of December each year and any Salary Reduction Agreement shall be effective as of January 1 of the next following year applicable to Compensation earned by such Participant during such year.

(c) Notwithstanding the provisions of Section 2.1.(b), a Participant who was scheduled to receive during 1996 a refund of excess employee contributions to the Graco Employee Investment Plan pursuant to the Employee Plans Voluntary Compliance Resolution ("VCR") with the Internal Revenue Service and a special payment of an amount equal to the employer match on the excess employee contributions may defer an amount equal to the amount of the employee contributions scheduled to be refunded plus the amount calculated for the special payment, if the Participant has executed a Special Deferred Compensation Plan Election, which shall be considered to be equivalent to a salary reduction agreement for purposes of the Plan, prior to receipt of such refund and special payment.

2. AMENDMENT. Effective for any amendment adopted after May 6, 1997, Section 7.1 of the Plan is amended to read in full as follows:

7.1. Amendment. The Employer, hereby reserves the power to amend this Plan prospectively or retroactively or both:

(a) In any respect by action of its Board of Directors; and

(b) In any respect that does not materially increase the cost of the Plan or significantly alter in scope, nature or degree the benefits accruing to the Participants, by action of the Management Organization and Compensation Committee of the Board of Directors; provided, however, that no amendment shall have the effect of amending this section 7 or of reducing or cancelling the accrued rights and benefits of present Participants.

3. SAVINGS CLAUSE. Save and except as herein above expressly amended, the Plan shall continue in full force and effect.

IN WITNESS WHEREOF, each of the parties hereto has caused these presents to be executed, all as of May 6, 1997.

GRACO INC.

By /s/Clyde W. Hansen  
Clyde W. Hansen  
Vice President

By /s/Robert M. Mattison  
Robert M. Mattison  
Vice President

LONG TERM STOCK INCENTIVE PLAN

1. Purpose. The purpose of the Graco Inc. Long Term Stock Incentive Plan (the "Plan") is to further the growth in earnings and market appreciation of Graco Inc. (the "Company"). The Plan provides substantial contributions to the Company through ability, performance, industry and invention. The Company intends that the Plan will thereby facilitate securing, retaining and motivating officers and key employees of high caliber and good potential.

2. Administration. The Plan shall be administered by a committee (the "Committee") selected by the Board of Directors of the Company (the "Board"). The Committee shall consist of three or more members who (a) need not be members of the Board of Directors or officers of the Company, (b) who shall be appointed by the Board and (c) who shall be "disinterested persons" within the meaning of Rule 16b-3 under the Securities Act of 1934 (the "Act"). No member of the Committee shall be eligible or receive awards under the Plan while serving on the Committee, and no member of the Committee shall have been eligible to receive awards for one year prior to serving on the Committee.

The Committee shall have full and final authority in its discretion to interpret the provisions of the Plan and to decide all questions of fact arising in its application; to determine the employees to whom awards shall be made under the Plan; to determine the type of award to be made and the amount, size, terms and conditions of each such award; to determine and establish additional terms and conditions not inconsistent with the Plan and for any agreements entered into with participants in connection with the Plan; to determine the time when awards will be granted and when rights may be exercised, which may be after termination of employment; and to make all other determinations necessary or advisable for the administration of the Plan.

The Committee shall select one of its members as its Chairman and shall hold its meetings at such times and places as it may determine. A majority of its members shall constitute a quorum. All determinations of the Committee shall be made by not less than a majority of its members. Any decision or determination reduced to writing and signed by all of the members of the Committee shall be fully effective as if it had been made by a majority vote at a meeting duly called and held. The granting of a stock option or restricted stock award pursuant to the Plan shall be effective only if a written agreement shall have been duly executed and delivered by and on behalf of the Company and, in the case of a restricted stock award, by the employee to whom such right is granted. The Committee may appoint a Secretary and may make such rules and regulations for the conduct of its business as it shall deem advisable.

3. Participants. Persons eligible to participate in the Plan shall be those officers and key employees of the Company or its subsidiaries who are in positions in which their decisions, actions and counsel significantly impact the performance of the Company or its subsidiaries. Directors of the Company who are not otherwise salaried employees of the Company shall not be eligible to receive awards under the Plan. For the purpose of awards of incentive stock options (as hereinafter defined) made under the Plan, the term "subsidiary" shall have the meaning given to it by Section 424 of the Internal Revenue Code of 1986, as amended (the "Code"). For the purpose of all other awards made under the Plan, the term "subsidiary" shall have the meaning given to it by Rule 405 promulgated under the Securities Act of 1933, as amended. References to "the Company" in this Plan or in any option or other award granted pursuant to the Plan shall be deemed references to a subsidiary if appropriate.

4. Awards under the Plan. Awards by the Committee under the Plan may be in the form of stock options intended to qualify as "incentive stock options" under the provision of Section 422 of the Code, stock options which do not qualify for special tax treatment under Section 422, restricted stock and other stock awards pursuant to such bonus and incentive plans as the Committee may deem appropriate.

4.1 Award Limitation. In any calendar year beginning with January 31, 1997, the Committee may not award stock options or stock appreciation rights on more than 200,000 Shares in the aggregate to any Participant who is an employee of the Company at the time of such award. This award limit may be adjusted in accordance with the provisions of Section 15. This limitation is intended to qualify the award of options and stock appreciation rights as performance-based compensation within the meaning of Section 162(m) of the Code.

5. Shares Subject to Plan. The shares that may be issued under the Plan shall not exceed in the aggregate 3,475,000 common shares, \$1.00 par value, of the Company. Except as otherwise provided herein, any shares subject to an option or right or other awards which for any reason expires or terminates without issuance or final vesting of such shares shall again be available under the Plan. No fractional shares shall be issued under the Plan.

6. Stock Options. Stock options shall be evidenced by stock option agreements in such form not inconsistent with the Plan as the Committee shall approve from time to time, which agreements shall contain in substance the following terms and conditions.

6.1. Option Price. The purchase price per common share deliverable upon the exercise of an option shall not be less than 100% of the fair market value of the stock on the day the option is granted, as determined by the Committee.

6.2. Exercise of Option. Each stock option agreement shall state the period or periods of time within which the option may be exercised by the participant, in whole or in part, which shall be such period or periods of time

as may be determined by the Committee, provided that the option period shall not end later than ten years after the date of the grant of the option.

6.3. Payment of Shares. An optionee electing to exercise an option shall give written notice to the Company of such election and of the number of shares subject to such exercise. The full purchase price of such shares shall be tendered with such notice of exercise or, at the discretion of the Committee, pursuant to any arrangements satisfactory to the Committee which provide that the Company will be paid at the time the shares are delivered to the optionee or his designee. Payment shall be made either in cash (including check, bank draft or money order) or, at the discretion of the Committee, (i) by delivering the Company's common shares already owned by the optionee having a fair market value equal to the full purchase price of the shares, or (ii) a combination of cash and such shares.

6.4. Special Rule for Incentive Stock Options. The aggregate fair market value (determined as of the time the option is granted) of the common shares with respect to which all incentive stock options granted after January 1, 1987 are exercisable for the first time by any individual during any calendar year (under all option plans of the Company and its parent and subsidiary corporations) shall not exceed \$100,000.

7. Restricted Stock Awards. Restricted stock awards shall be evidenced by restricted stock agreements in such form not inconsistent with the Plan as the Committee shall approve from time to time, which agreements shall contain in substance the following terms and conditions.

7.1. Restriction Period. Shares awarded pursuant to restricted stock awards shall be subject to such conditions, terms and restrictions (including continued employment, achievement of performance targets, forfeiture and transfer) and for such period or periods as shall be determined by the Committee. The Committee shall have the power, in its discretion, to permit an acceleration of the expiration of the applicable restriction period with respect to any part of all of the shares awarded to a participant.

7.2 Restrictions Upon Transfer. The common shares subject to an award, may not be sold, assigned, transferred, exchanged, pledged, hypothecated, or otherwise encumbered, except as herein provided, during the restriction period applicable to such shares, but a participant shall have all the other rights of a stockholder, including the right to receive cash dividends and the right to vote such shares, until such time as the restrictions have lapsed or the shares have been forfeited.

7.3 Certificates. Each certificate issued in respect of common shares awarded to a participant shall be deposited with the Company, or its designee, and shall bear an appropriate legend noting the existence of restrictions upon the transfer of such Common Stock.

7.4 Lapse of Restrictions. The agreement governing the awards shall specify the conditions and terms upon which any restrictions upon shares awarded under the Plan shall lapse, as determined by the Committee. Upon lapse of such restrictions, common shares free of any restrictive legend, other than as may be required under Section 9 hereof, shall be issued and delivered to the participant or his legal representative.

8. Fair Market Value. The fair market value of the Company's common shares for purposes of the Plan shall be the last sale price of the common shares as reported on the New York Stock Exchange on the business day as of which the fair market value is being determined or if no sale occurred on that date, the last sale on the most recent date for which a sale is reported. If the Company's common shares are not then traded on the New York Stock Exchange, the Committee may determine fair market value in some other reasonable way.

9. General Restrictions. Each award under the Plan shall be subject to the requirement that, if at anytime the Committee shall determine that (a) the listing, registration or qualification of the common shares subject or related thereto upon any securities exchange or under any state or federal law, or (b) the consent or approval of any government regulatory body, or (c) an agreement by the recipient of an award with respect to the disposition of common shares, is necessary or desirable in connection with, the granting of such award or the issue or purchase of common shares thereunder, such award may not be consummated in whole or in part unless such listing, registration, qualification, consent, approval or agreement shall have been effected or obtained free of any conditions not acceptable to the Committee. A participant shall agree, as a condition of receiving any award under the Plan, to execute any documents, make any representations, agree to restrictions on stock transferability and take any actions which in the opinion of legal counsel to the Company is required by any applicable law, ruling or regulation.

10. Rights of a Shareholder. The recipient of any award under the Plan, unless otherwise provided by the Plan, shall have no rights as a shareholder with respect thereto unless and until certificates for common shares are issued to the recipient.

11. Right to Terminate Employment. Nothing in the Plan or in any agreement entered into pursuant to the Plan shall confer upon any participant the right to continue in the employment of the Company or its subsidiaries, or affect any right which the Company or such subsidiaries may have to terminate the employment of the participant.

12. Withholding.

12.1. Payment of Withholding Taxes. Whenever the Company proposes or is required to issue or transfer common shares under the Plan, the Company shall have the right to require the recipient to remit to the Company, or provide indemnification satisfactory to the Company for, an amount sufficient to satisfy any federal, state or local withholding tax requirements prior to the issuance



or delivery of any certificate or certificates for such shares.

12.2. Use of Common Shares to Satisfy Tax Obligation. In order to assist an optionee or grantee in paying all federal, state and local taxes to be withheld or collected upon exercise of an option or the grant of a stock award or the lapse of restrictions relating to a restricted stock award hereunder, the Committee in its sole discretion and subject to such rules as it may adopt, may permit the optionee or grantee to satisfy such tax obligation, in whole or in part, by (i) electing to have the Company withhold common shares otherwise to be delivered with a fair market value equal to the amount of such tax obligation, or (ii) electing to surrender to the Company previously owned common shares with a fair market value equal to the amount of such tax obligation. The election must be made on or before the date that the amount of tax to be withheld is determined.

13. Non-Assignability. No award under the Plan shall be assignable or transferable by the participant except by will or by laws of descent and distribution. During the life of a participant, such award shall be exercisable only by the participant or by the participant's guardian or legal representative.

14. Non-Uniform Determinations. The Committee's determinations under the Plan (including, without limitation, determinations of the persons to receive awards, the form, amount and timing of such awards, the terms and provisions of awards and the agreements evidencing the awards, and the establishment of values and performance targets) need not be uniform and may be made by it selectively among persons who receive, or are eligible to receive, awards under the Plan whether or not such persons are similarly situated.

15. Adjustments in Shares. In the event of any change in the outstanding common shares of the Company by reason of a stock dividend or distribution, recapitalization, merger, consolidation, split-up, combination, exchange of shares or otherwise, the Board shall adjust the number of shares which may be issued under the Plan and the Board shall provide for an equitable adjustment of any shares issuable pursuant to awards outstanding under the Plan.

#### 16. Adoption, Amendment and Termination.

16.1. Adoption. This Plan was originally adopted in February 1982 as the Graco Inc. Incentive Stock Option Plan. The Plan was amended and restated as the Graco Inc. Long Term Stock Incentive Plan by the Board of Directors on March 4, 1988 and was further amended by the Board on December 13, 1991, February 21, 1992, February 23, 1996 and May 7, 1996, which amendments requiring shareholder approval were approved by the shareholders on May 5, 1992 and May 7, 1996, respectively.

16.2 Amendment. The Board may amend, suspend, or terminate the Plan at any time, but without shareholder approval, no amendment shall materially increase the maximum number of shares which may be issued under the Plan (other than increases pursuant to Section 15 hereof), materially increase the benefits accruing to participants under the Plan, materially modify the requirements as to eligibility for participation, or extend the term of the Plan.

16.3. Termination. Unless the Plan shall have been discontinued at an earlier date, the Plan shall terminate on December 13, 2001. No option, restricted stock award or stock awards may be granted after such termination, but termination of the Plan shall not, without the consent of the optionee or grantee, alter or impair any rights or obligations under any award theretofore granted.

May 6, 1997

GRACO INC.  
NONEMPLOYEE DIRECTOR STOCK PLAN  
("PLAN")

1. Purpose of the Plan. The purpose of the Graco Inc. Nonemployee Director Stock Plan (the "Plan") is to provide an opportunity for nonemployee members of the Board of Directors (the "Board") of Graco Inc. ("Graco" or the "Company") to increase their ownership of Graco Common Stock ("Common Stock") and thereby align their interest in the long-term success of the Company with that of the other shareholders. Each nonemployee director may elect to receive all or a portion of his or her retainer in the form of shares of Common Stock or defer the receipt of such shares until a later date pursuant to an election made under the Plan.

2. Eligibility. Directors of the Company who are not also officers or other employees of the Company or its subsidiaries are eligible to participate in the Plan ("Eligible Directors").

3. Administration. The Plan will be administered by the Secretary of the Company (the "Administrator"). Since the issuance of shares of Common Stock pursuant to the Plan is based on elections made by Eligible Directors, the Administrator's duties under the Plan will be limited to matters of interpretation and administrative oversight. All questions of interpretation of the Plan will be determined by the Administrator, and each determination, interpretation or other action that the Administrator makes or takes pursuant to the provisions of the Plan will be conclusive and binding for all purposes and on all persons. The Administrator will not be liable for any action or determination made in good faith with respect to the Plan.

4. Election to Receive Stock and Stock Issuance.

4.1. Election to Receive Stock/Credit in Lieu of Cash. On forms provided by the Company, each Eligible Director may irrevocably elect ("Stock Election") in lieu of cash, (i) to be issued shares of Common Stock or (ii) to have credited to an account ("Deferred Stock Account") the number of shares of Common Stock having a Fair Market Value, as defined in Section 4.3, equal to 25%, 50%, 75% or 100% of the annual cash retainer (the "Retainer") payable to that director for services rendered as a director ("Participating Director"). A Stock Election shall apply only to the Retainer and not to any fees payable for attendance at Board or Committee meetings. Eligible Directors are customarily paid the Retainer in quarterly installments in arrears at the end of each fiscal quarter. Any Stock Election must be received by the Company before the commencement of the fiscal quarter with respect to which such election is made. Any Stock Election may only be amended or revoked ("Amended Stock Election") in accordance with the procedure set forth in Section 4.4.

4.2. Issuance of Stock/Application of Credit in Lieu of Cash. If the Stock Election is for the issuance of shares of Common Stock, shares of Common Stock having a Fair Market Value equal to the amount of the Retainer so elected shall be issued to each Participating Director when each quarterly installment of the Retainer is customarily paid. The Company shall not issue fractional shares, but in lieu thereof shall pay cash of equivalent value using the same Fair Market Value used to determine the number of Shares to be issued on the relevant issue date. If the Stock Election is for a credit to a Deferred Stock Account, the number of shares of Common Stock (rounded to the nearest hundredth of a share) having a Fair Market Value equal to the amount of the Retainer so elected shall be credited to the Participating Director's Deferred Stock Account when each quarterly installment of the Retainer is customarily paid. In the event that a Participating Director elects to receive less than 100% of each quarterly installment of the Retainer in shares of Common Stock, either issued or credited, he shall receive the balance of the quarterly installment in cash.

4.3 Fair Market Value. For purposes of converting dollar amounts into shares of Common Stock, the Fair Market Value of each share of Common Stock shall be equal to the closing price of one share of the Company's Common Stock on the New York Stock Exchange-Composite Transactions on the last business day of the fiscal quarter for which such shares are issued or credited.

4.4. Change in Election. Each Participating Director may irrevocably elect in writing to change an earlier Stock Election, either to elect to be issued shares of Common Stock or to have credited to the Participating Director's Deferred Stock Account, a number of shares of Common Stock having a Fair Market Value equal to a percentage of the Participating Director's Retainer different from the percentage previously elected or to receive the entire Retainer in cash (an "Amended Stock Election"). An Amended Stock Election shall not become effective until the commencement of the first full fiscal quarter after the date of receipt of such Amended Stock Election by the Company.

4.5 Termination of Service as a Director. If a Participating Director leaves the Board before the conclusion of any fiscal quarter, he or she will be paid the quarterly installment of the Retainer entirely in cash, notwithstanding that a Stock Election or Amended Stock Election is on file with the Company. The date of termination of a Participating Director's service as a director of the Company will be deemed to be the date of termination recorded on the personnel or other records of the Company.

4.6 Dividend Credit. Each time a dividend is paid on the Common Stock,

each Participating Director who has a Deferred Stock Account shall receive a credit to his or her Deferred Stock Account equal to that number of shares of Common Stock (rounded to the nearest one-hundredth of a share) having a Fair Market Value on the dividend payment date equal to the amount of the dividend payable on the number of shares of Common Stock credited to the Participating Director's Deferred Stock Account on the dividend record date.

## 5. Shares Available for Issuance.

5.1. Maximum Number of Shares Available. The maximum number of shares of the Company's Common Stock, par value \$1.00 per share, that will be available for issuance under the Plan will be 150,000 shares, subject to any adjustments made in accordance with the provisions of Section 5.2. At the election of the Administrator, the shares of Common Stock available for issuance under the Plan may be either authorized but unissued shares or treasury shares. If treasury shares are used, all references in the Plan to the issuance of shares will be deemed to mean the transfer of shares from treasury.

5.2. Adjustments to Shares. In the event of any reorganization, merger, consolidation, recapitalization, liquidation, reclassification, stock dividend, stock split, combination of shares, rights offering, divestiture or extraordinary dividend, an appropriate adjustment will be made in the number and/or kind of securities available for issuance under the Plan to prevent either the dilution or the enlargement of the rights of the Eligible and Participating Directors.

## 6. Deferral Payment

6.1 Deferral Payment Election. At the time of making the Stock Election in which the Participating Director elects to have a Deferred Stock Account credited in accordance with the provisions of Section 4.1, the Participating Director will also elect the manner and timing for payment of the amounts credited to his or her Deferred Stock Account ("Deferral Payment Election") from the alternatives described in Section 6.2. The Participating Director may change the manner and timing for payment of amounts to be credited to his or her Deferred Stock Account by executing another Deferral Payment Election; provided, however, that the previously made Deferral Payment Election will be irrevocable as to all amounts credited to the Participating Director's Deferred Stock Account prior to receipt by the Company of a new Deferral Payment Election.

6.2 Payment from Deferred Stock Accounts. A Participating Director may elect to receive payment from his or her Deferred Stock Account in a lump sum or installments. Payments, whether in a lump sum or by installments, shall be made in shares of Common Stock plus cash in lieu of any fractional share. Unless the Participating Director elects to receive payment in installments, credits to a Participating Director's Deferred Stock Account shall be payable in full on January 10 of the year following the Participating Director's termination of service on the Board, or the first business day thereafter, or such other date as elected by the Participating Director pursuant to Section 6.1. If the Participating Director elects to receive payment from his or her Deferred Stock Account in installments, each installment payment will be made annually on January 10 of each year, or the first business day thereafter, and the amount of each payment will be computed by multiplying the number of shares credited to the Deferred Stock Account as of January 10 of each year by a fraction, the numerator of which is one and the denominator of which is the total number of installments elected (not to exceed fifteen) minus the number of installments previously paid. Amounts paid prior to the final installment payment will be rounded to the nearest whole number of shares; the final installment payment shall be for the whole number of shares remaining credited to the Deferred Stock Account, plus cash in lieu of any fractional share.

6.3 Change of Control. Notwithstanding the foregoing, in the event of a Change of Control (as defined in Section 11), the number of shares credited to the Deferred Stock Account of a Participating Director as of the business day immediately prior to the effective date of the transaction constituting the Change of Control, shall be paid in full to the Participating Director or the Participating Director's beneficiary or estate, as the case may be, in whole shares of Common Stock plus cash in lieu of any fractional share on the tenth business day following the effective date of the transaction constituting the Change of Control.

## 7. Limitation on Rights of Eligible and Participating Directors.

7.1. Service as a Director. Nothing in the Plan will interfere with or limit in any way the right of the Company's Board or its shareholders to remove an Eligible or Participating Director from the Board. Neither the Plan nor any action taken pursuant to it will constitute or be evidence of any agreement or understanding, express or implied, that the Company's Board or its shareholders have retained or will retain an Eligible or Participating Director for any period of time or at any particular rate of compensation.

7.2. Nonexclusivity of the Plan. Nothing contained in the Plan is intended to effect, modify or rescind any of the Company's existing compensation plans or programs or to create any limitations on the Board's power or authority to modify or adopt compensation arrangements as the Board may from time to time deem necessary or desirable.

8. Plan Amendment, Modification and Termination. The Board may suspend or terminate the Plan at any time. The Board may amend the Plan from time to time in such respects as the Board may deem advisable in order that the Plan will conform to any change in applicable laws or regulations or in any other respect

that the Board may deem to be in the Company's best interests; provided, however, that no amendments to the Plan will be effective without approval of the Company's shareholders, if shareholder approval of the amendment is then required pursuant to Rule 16b-3 (or any successor rule) under the Securities Exchange Act of 1934, as amended, (the "Exchange Act") or the rules of the New York Stock Exchange. In addition, the Plan may not be amended more than once every six months other than to conform it with changes in the Internal Revenue Code, as amended, the Employee Retirement Income Security Act of 1974, as amended, or the rules thereunder.

9. Effective Date and Duration of the Plan. The Plan shall become effective as of the date the Company's shareholders approve it and will terminate on December 31, 2003, unless earlier terminated by the Company's Board.

10. Participants are General Creditors of the Company. The Participating Directors and beneficiaries thereof shall be general, unsecured creditors of the Company with respect to any payments to be made pursuant to the Plan and shall not have any preferred interest by way of trust, escrow, lien or otherwise in any specific assets of the Company. If the Company shall, in fact, elect to set aside monies or other assets to meet its obligations hereunder (there being no obligation to do so), whether in a grantor's trust or otherwise, the same shall, nevertheless, be regarded as part of the general assets of the Company subject to the claims of its general creditors, and neither any Participating Director nor any beneficiary thereof shall have a legal, beneficial or security interest therein.

#### 11. Change of Control

11.1 A "Change of Control" means any one of the following events:

(1) acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 under the Exchange Act) which results in the beneficial ownership by such Person of 25% or more of either

(a) the then outstanding shares of Common Stock of the Company (the "Outstanding Company Common Stock") or

(b) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities"); provided, however, that the following acquisitions will not result in a Change of Control:

(i) an acquisition directly from the Company,

(ii) an acquisition by the Company,

(iii) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,

(iv) an acquisition by any Person who is deemed to have beneficial ownership of the Common Stock or other voting securities of the Company owned by the Trust Under the Will of Clarissa L. Gray ("Trust Person"), provided that such acquisition does not result in the beneficial ownership by such Person of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, and provided further that for purposes of this Section 11, a Trust Person shall not be deemed to have beneficial ownership of the Common Stock or other voting securities of the Company owned by The Graco Foundation or any employee benefit plan of the Company, including the Graco Employee Retirement Plan and the Graco Employee Stock Ownership Plan,

(v) an acquisition by the Participating Director or any group that includes the Participating Director, or

(vi) an acquisition by any corporation pursuant to a transaction that complies with clauses (a), (b) and (c) of subsection (4) below; and provided, further, that if any Person's beneficial ownership of the Outstanding Company Common Stock or Outstanding Company Voting Securities is 25% or more as a result of a transaction described in clause (i) or (ii) above, and such Person subsequently acquires beneficial ownership of additional Outstanding Company Common Stock or Outstanding Company Voting Securities as a result of a transaction other than that described in clause (i) or (ii) above, such subsequent acquisition will be treated as an acquisition that causes such Person to own 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities and be deemed a Change of Control; and provided further, that in the event any acquisition or other transaction occurs which results in the beneficial ownership of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities by any Trust Person, the Incumbent Board, as defined below, may by majority vote increase the threshold beneficial ownership percentage to a percentage above 32% for any Trust Person; or

(2) individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising

the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board, or

(3) the commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a Person of 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities; or

(4) the approval by the shareholders of the Company of a reorganization, merger, consolidation or statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination") or, if consummation of such Business Combination is subject, at the time of such approval by shareholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation); excluding, however, such a Business Combination pursuant to which

(a) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,

(b) no Person (excluding any employee benefit plan, or related trust, of the Company or such corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation, except to the extent that such ownership existed prior to the Business Combination, and

(c) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

(5) approval by the shareholders of the Company of a complete liquidation or dissolution of the Company.

11.2 A Change of Control shall not be deemed to have occurred with respect to a Participating Director if:

(1) the acquisition of the 25% or greater interest referred to in subparagraph 11.1(1) of this Section 11 is by a group, acting in concert, that includes the Participating Director or

(2) if at least 25% of the then outstanding common stock or combined voting power of the then outstanding company voting securities (or voting equity interests) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Company shall be beneficially owned, directly or indirectly, immediately after a reorganization, merger, consolidation, statutory share exchange, disposition of assets, liquidation or dissolution referred to in subparagraph 11.1(4) or (5) of this Section by a group, acting in concert, that includes that Participating Director.

## 12. Miscellaneous.

12.1 Securities Law and Other Restrictions. Notwithstanding any other provision of the Plan or any Stock Election or Amended Stock Election delivered pursuant to the Plan, the Company will not be required to issue any shares of Common Stock under the Plan and a Participating Director may not sell, assign, transfer or otherwise dispose of shares of Common Stock issued pursuant to the Plan, unless:

(a) there is in effect with respect to such shares a registration statement under the Securities Act of 1933, as amended (the "Securities Act") and any applicable state securities laws or an exemption from such registration under the Securities Act and applicable state securities laws, and

(b) there has been obtained any other consent, approval or permit from any other regulatory body that the Administrator, in his or her sole discretion, deems necessary or advisable. The Company may condition such issuance, sale or transfer upon the receipt of any representations or agreements from the parties involved, and the placement of any legends on certificates representing shares of Common Stock, as may be deemed necessary or advisable by the Company, in order to comply with such securities law or other restriction.

12.2. Governing Law The validity, construction, interpretation, administration and effect of the Plan and any rules, regulations and actions relating to the Plan will be governed by and construed exclusively in accordance with the laws of the State of Minnesota.

GRACO INC. NONEMPLOYEE DIRECTOR STOCK OPTION PLAN

1. Purpose

The purpose of the Graco Inc. Nonemployee Director Stock Option Plan (the "Plan") is to secure for Graco Inc. (the "Company") and its shareholders the benefits of the long-term incentives inherent in increased common stock ownership by the members of the Board of Directors (the "Board") of the Company who are not employees of the Company or its Affiliates, by strengthening the identification of Nonemployee Directors with the interests of all Graco shareholders.

2. Definitions

The terms defined in this Section 2 shall have the following meanings, unless the context otherwise requires.

- a. Affiliate shall mean any corporation, partnership, joint venture or other entity in which the Company holds an equity, profit or voting interest of more than fifty percent (50%).
- b. Annual Meeting of Shareholders shall mean the annual meeting of shareholders of the Company held each calendar year.
- c. Code shall mean the Internal Revenue Code of 1986, as amended to date and as it may be amended from time to time.
- d. Company shall mean Graco Inc., a Minnesota corporation.
- e. ERISA shall mean the Employee Retirement Income Security Act of 1974, as amended to date and as it may be amended from time to time.
- f. Fair Market Value per Share shall mean as of any day
  - (1) The fair market value of a share of the Company's common stock is the last sale price reported on the composite tape by the New York Stock Exchange on the business day immediately preceding the date as of which fair market value is being determined or, if there were no sales of shares of the Company's common stock reported on the composite tape on such day, on the most recently preceding day on which there were sales, or
  - (2) if the shares of the Company's stock are not listed or admitted to trading on the New York Stock Exchange on the day as of which the determination is made, the amount determined by the Board or its delegate to be the fair market value of a share on such day.
- g. Nonemployee Director shall mean a member of the Board of Directors of the Company who is not also an officer or other employee of the Company or an Affiliate.
- h. Nonstatutory Stock Option ("NSO") shall mean a stock option, which does not qualify for special tax treatment under Sections 421 or 422 of the Internal Revenue Code.
- i. Option shall mean either a First Option or an Annual Option granted pursuant to the provisions of Section 4 of this Plan.
- j. Participant shall mean any person who holds an Option granted under this Plan.
- k. Plan shall mean this Graco Inc. Nonemployee Director Stock Option Plan.

3. Administration

- a. The Plan shall be administered by the Board. The Board may, by resolution, delegate part or all of its administrative powers with respect to the Plan.
- b. The Board shall have all of the powers vested in it by the terms of the Plan, such powers to include the authority, within the limits prescribed herein, to establish the form of the agreement embodying grants of Options made under the Plan.
- c. The Board shall, subject to the provisions of the Plan, have the power to construe the Plan, to determine all questions arising thereunder and to adopt and amend such rules and regulations for the administration of the Plan as it may deem desirable, such administrative decisions of the Board to be final and conclusive.
- d. The Board shall have no discretion to select the Nonemployee Directors to receive Option grants under the Plan, to determine the number of shares of the Company's common stock subject to the Plan or to each grant, nor the exercise price of the Options granted pursuant to the Plan.
- e. The Board may authorize any one or more of their number or the Secretary or any other officer of the Company to execute and deliver documents on behalf of the Board. The Board hereby authorizes the Secretary to execute and deliver all documents to be delivered by the Board pursuant to the Plan.

f. The expenses of the Plan shall be borne by the Company.

#### 4. Automatic Grants to Nonemployee Directors

- a. As of the date of adoption of this Plan by the shareholders of the Company, each Nonemployee Director shall be granted an option to purchase two thousand (2,000) shares of the Company's common stock under the Plan (the "First Option"). Thereafter, as of the day upon which shareholders vote to elect directors at each annual meeting of the Company, each Nonemployee Director of the Board shall be granted an additional option to purchase fifteen hundred (1,500) shares of the Company's common stock under the Plan (the "Annual Option"); provided, however, that a Nonemployee Director who has not previously been elected as a member of the Board of Directors of the Company shall also be granted a First Option; i.e., an option to purchase two thousand (2,000) shares of the Company's common stock under the Plan, on the first business day of the Nonemployee Director's election to the Board, including election by the Board of Directors to fill a vacancy on the Board.
- b. The automatic grants to Nonemployee Directors shall not be subject to the discretion of any person.
- c. Each Option granted under the Plan shall be evidenced by a written Agreement. Each Agreement shall be subject to, and incorporate, by reference or otherwise, the applicable terms of this Plan.
- d. During the lifetime of a Participant, each Option shall be exercisable only by the Participant. No Option granted under the Plan shall be assignable or transferable by the Participant, except by will or by the laws of descent and distribution.

#### 5. Shares of Stock Subject to the Plan

- a. Subject to adjustment as provided in Section 11 of the Plan, an aggregate of two hundred thousand (200,000) shares of the Company's common stock, \$1.00 par value, shall be available for issuance to Nonemployee Directors under the Plan. No fractional shares shall be issued.
- b. First Option Grants and Annual Option Grants shall reduce the shares available for issuance under the Plan by the number of shares subject thereto. The shares deliverable upon exercise of any First Option Grant or Annual Option Grant may be made available from authorized but unissued shares or shares reacquired by the Company, including shares purchased in the open market or in private transactions. If any unexercised First Option Grant or Annual Option Grant shall terminate for any reason, the shares subject to, but not delivered under, such First Option Grant or Annual Option Grant shall be available for other First Option Grants or Annual Option Grants.

#### 6. Nonstatutory Options.

- a. All Options granted to Nonemployee Directors pursuant to the Plan shall be NSOs.

#### 7. Exercise Price.

- a. The price per share of the shares of the Company's common stock which may be purchased upon exercise of an Option ("Exercise Price") shall be one hundred percent (100%) of the Fair Market Value per Share on the date the Option is granted and shall be payable in full at the time the Option is exercised as follows:
  - (1) in cash or by certified check,
  - (2) by delivery of shares of common stock to the Company which shall have been owned for at least six (6) months and have a Fair Market Value per Share on the date of surrender equal to the exercise price, or
  - (3) by delivery to the Company of a properly executed exercise notice together with irrevocable instructions to a broker to promptly deliver to the Company from sale or loan proceeds the amount required to pay the exercise price.
- b. Such price shall be subject to adjustment as provided in Section 11 hereof.

#### 8. Duration and Vesting of Options.

- a. The term of each Option granted to a Nonemployee Director shall be for ten (10) years from the date of grant, unless terminated earlier pursuant to the provisions of Section 10 hereof.
- b. Each Option shall vest and become exercisable according to the following schedule:
  - (1) twenty-five percent (25%) of the total number of shares covered by the Option shall become exercisable beginning with the first anniversary date of the grant of the Option;
  - (2) thereafter twenty-five percent (25%) of the total number of shares covered by the Option shall become exercisable on each subsequent anniversary date of the grant of the Option until the fourth anniversary date of the grant of the Option upon which the total number of shares covered by Option shall become



exercisable.

## 9. Change of Control

a. Notwithstanding Section 8b(1) and (2) hereof, all outstanding Options not yet exercisable shall become immediately and fully exercisable on the day following a "Change of Control" and shall remain fully exercisable until either exercised or expiring by their terms. A "Change of Control" means:

(1) acquisition by any individual, entity, or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act of 1934), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 under the 1934 Act) which results in the beneficial ownership by such Person of 25% or more of either

(a) the then outstanding shares of common stock of the Company (the "Outstanding Company Common Stock") or

(b) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities");

provided, however, that the following acquisitions will not result in a Change of Control:

(i) an acquisition directly from the Company,

(ii) an acquisition by the Company,

(iii) an acquisition by an employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,

(iv) an acquisition by any Person who is deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by the Trust Under the Will of Clarissa L. Gray ("Trust Person"), provided that such acquisition does not result in the beneficial ownership by such Person of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, and provided further that for purposes of this Section 9, a Trust Person shall not be --- deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by The Graco Foundation or any employee benefit plan of the Company, including, without limitations, the Graco Employee Retirement Plan and the Graco Employee Stock Ownership Plan,

(v) an acquisition by the Nonemployee Director or any group that includes the Nonemployee Director, or

(vi) an acquisition by any corporation pursuant to a transaction that complies with clauses (a), (b), and (c) of subsection (4) below; and provided, further, that if any Person's beneficial ownership of the Outstanding Company Common Stock or Outstanding Company Voting Securities is 25% or more as a result of a transaction described in clause (i) or (ii) above, and such Person subsequently acquires beneficial ownership of additional Outstanding Company Common Stock or Outstanding Company Voting Securities as a result of a transaction other than that described in clause (i) or (ii) above, such subsequent acquisition will be treated as an acquisition that causes such Person to own 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities and be deemed a Change of Control; and provided further, that in the event any acquisition or other transaction occurs which results in the beneficial ownership of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities by any Trust Person, the Incumbent Board may by majority vote increase the threshold beneficial ownership percentage to a percentage above 32% for any Trust Person; or

(2) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board; or

(3) The commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a Person of 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting

Securities; or

(4) The approval by the shareholders of the Company of a reorganization, merger, consolidation, or statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination") or, if consummation of such Business Combination is subject, at the time of such approval by stockholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation) excluding, however, such a Business combination pursuant to which

(a) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,

(b) no Person [excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination] beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and

(c) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

(5) approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.

b. A Change of Control shall not be deemed to have occurred with respect to a Nonemployee Director if:

(1) the acquisition of the 25% or greater interest referred to in subsection a(1) of this Section 9 is by a group, acting in concert, that includes the Nonemployee Director or

(2) if at least 25% of the then outstanding common stock or combined voting power of the then outstanding company voting securities (or voting equity interests) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Company shall be beneficially owned, directly or indirectly, immediately after a reorganization, merger, consolidation, statutory share exchange, disposition of assets, liquidation or dissolution referred to in subsections (4) or (5) of this section by a group, acting in concert, that includes that Nonemployee Director.

#### 10. Effect of Termination of Membership on the Board.

a. The right to exercise an Option granted to a Nonemployee Director shall be limited as follows, provided the actual date of exercise is in no event after the expiration of the term of the Option:

(1) If a Nonemployee Director ceases being a director of the Company for any reason other than the reasons identified in subparagraph

(2) of this Section 10, the Nonemployee Director shall have the right to exercise the Options as follows, subject to the condition that no Option shall be exercisable after the expiration of the term of the Option:

(a) If the Nonemployee Director was a member of the Board of Directors of the Company for five (5) or more years, all outstanding Options become immediately exercisable upon the date the Nonemployee Director ceases being a director. The Nonemployee Director may exercise the Options for a period of thirty-six months (36) from the date the Nonemployee Director ceased being a director, provided that if the Nonemployee Director dies before the thirty-six (36) month period has expired, the Options may be exercised by the Nonemployee Director's legal representative or any person who acquires the right to exercise an Option by reason of the Nonemployee Director's death for a period of twelve (12) months from the date of the Nonemployee Director's death.

(b) If the Nonemployee Director was a member of the Board of

Directors of the Company for less than five (5) years, the Nonemployee Director may exercise the Options, to the extent they were exercisable at the date the Nonemployee Director ceases being a member of the Board, for a period of thirty (30) days following the date the Nonemployee Director ceased being a director, provided that, if the Nonemployee Director dies before the thirty (30) day period has expired, the Options may be exercised by the Nonemployee Director's legal representative, or any person who acquires the right to exercise an Option by reason of the Nonemployee Director's death, for a period of twelve (12) months from the date of the Nonemployee Director's death.

(c) If the Nonemployee Director dies while a member of the Board, the Options, to the extent exercisable by the Nonemployee Director at the date of death, may be exercised by the Nonemployee Director's legal representative, or any person who acquires the right to exercise an Option by reason of the Nonemployee Director's death, for a period of twelve (12) months from the date of the Nonemployee Director's death.

(d) In the event any Option is exercised by the executors, administrators, legatees, or distributees of the estate of a deceased optionee, the Company shall be under no obligation to issue stock thereunder unless and until the Company is satisfied that the person or persons exercising the Option are the duly appointed legal representatives of the deceased optionee's estate or the proper legatees or distributees thereof.

(2) If a Nonemployee Director ceases being a director of the Company due to an act of

(a) fraud or intentional misrepresentation or

(b) embezzlement, misappropriation or conversion of assets or opportunities of the Company or any Affiliate of the Company or

(c) any other gross or willful misconduct as determined by the Board, in its sole and conclusive discretion, all Options granted to such Nonemployee Director shall immediately be forfeited as of the date of the misconduct.

#### 11. Adjustments and Changes in the Stock

a. If there is any change in the common stock of the Company by reason of any stock dividend, stock split, spin-off, split-up, merger, consolidation, recapitalization, reclassification, combination or exchange of shares, or any other similar corporate event, the aggregate number of shares available under the Plan, the number and the price of shares of common stock subject to outstanding Options and the number of shares referenced by the terms, "First Option" and "Annual Option", respectively, in Section 4a hereof, shall be appropriately adjusted automatically.

b. No right to purchase fractional shares shall result from any adjustment in Options pursuant to this Section 11. In case of any such adjustment, the shares subject to the Option shall be rounded down to the nearest whole share.

c. Notice of any adjustment shall be given by the Company to each holder of any Option which shall have been so adjusted and such adjustment (whether or not such notice is given) shall be effective and binding for all purposes of the Plan.

#### 12. Effective Date of the Plan

a. The Plan shall become effective on the date it is approved by the shareholders of the Company.

b. Any amendment to the Plan shall become effective when adopted by the Board, unless specified otherwise, but no Option granted under any increase in shares authorized to be issued under this Plan shall be exercisable until the increase is approved in the manner prescribed in Section 13 of this Plan.

#### 13. Amendment of the Plan

a. The Board of Directors may amend, suspend or terminate the Plan at any time, but without shareholder approval, no amendment shall materially increase the maximum number of shares which may be issued under the Plan (other than adjustments pursuant to Section 11 hereof), materially increase the benefits accruing to Participants under the Plan, materially modify the requirements as to eligibility for participation or extend the term of the Plan. Approval of the shareholders may be obtained, at a meeting of shareholders duly called and held, by the affirmative vote of a majority of the holders of the Company's voting stock who are present or represented by proxy and are entitled to vote on the Plan.

b. It is intended that the Plan meet the requirements of Rule 16b-3 or any successor thereto promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended, including any applicable requirements regarding shareholder approval. Amendments to the Plan shall be subject to approval by the

shareholders of the Company to the extent determined by the Board of Directors to be necessary to satisfy such requirements as in effect from time to time.

- c. Rights and obligations under any Option granted before any amendment of this Plan shall not be materially and adversely affected by amendment of the Plan, except with the consent of the person who holds the Option, which consent may be obtained in any manner that the Board or its delegate deems appropriate.
- d. The Board of Directors may not amend the provisions of Sections 4, 6, 7, 8 and 10 hereof more than once every six (6) months, other than to comport with changes in the Code, ERISA, or the rules thereunder.

#### 14. Termination of the Plan

- a. The Plan, unless sooner terminated, shall terminate at the end of ten (10) years from the date the Plan is approved by the shareholders of the Company. No Option may be granted under the Plan while the Plan is suspended or after it is terminated.
- b. Rights or obligations under any Option granted while the Plan is in effect, including the maximum duration and vesting provisions, shall not be altered or impaired by suspension or termination of the Plan, except with the consent of the person who holds the Option, which consent may be obtained in any manner that the Board or its delegate deems appropriate.

#### 15. Registration, Listing, Qualification, Approval of Stock and Options

- a. If the Board shall determine, in its discretion, that it is necessary or desirable that the shares of common stock subject to any Option
  - (1) be registered, listed or qualified on any securities exchange or under any applicable law, or
  - (2) be approved by any governmental regulatory body, or
  - (3) approved by the shareholders of the Company, as a condition of, or in connection with, the granting of such Option, or the issuance or purchase of shares upon exercise of the Option, the Option may not be exercised in whole or in part unless such registration, listing, qualification or approval has been obtained free of any condition not acceptable to the Board of Directors.

#### 16. No Right to Option or as Shareholder

- a. No Nonemployee Director or other person shall have any claim or right to be granted an Option under the Plan, except as expressly provided herein. Neither the Plan nor any action taken hereunder shall be construed as giving any Nonemployee Director any right to be retained in the service of the Company.
- b. Neither a Nonemployee Director, the Nonemployee Director's legal representative, nor any person who acquires the right to exercise an Option by reason of the Nonemployee Director's death shall be, or have any of the rights or privileges of, a shareholder of the Company in respect of any shares of common stock receivable upon the exercise of any Option granted under this Plan, in whole or in part, unless and until certificates for such shares shall have been issued.

#### 17. Governing Law

The validity, construction, interpretation, administration and effect of this Plan and any rules, regulations and actions relating to this Plan will be governed by and construed exclusively in accordance with the laws of the State of Minnesota.

AMENDMENT TO  
STOCK OPTION AGREEMENT  
(NON-ISO)

This Amendment made this 14th day of April, 1997, by and between Graco Inc., a Minnesota corporation (the "Company") and \_\_\_\_\_ (the "Employee").

Whereas, the Employee and the Company entered into a Stock Option Agreement (NON-ISO) on \_\_\_\_\_ ("Agreement") which Agreement granted stock options to the Employee under the Graco Inc. Long-Term Stock Incentive Plan;

Whereas, the parties to the Agreement wish to amend it to incorporate language which will accelerate the vesting of all unvested stock options in the event of a change in control as defined in said amendment;

Now, therefore, the parties hereby mutually agree, for One Dollar and other good and valuable consideration, to amend the Agreement by inserting the attached Section 6, entitled "Change of Control" into the Agreement after Section 5 entitled "Payment of Withholding Taxes" and by renumbering Section 6 and 7 in the Agreement as Section 7 and 8, respectively.

In Witness Whereof, the parties have caused this Amendment to be executed as of the day and year first above written.

GRACO INC.

By

-----  
Its: President and CEO

EMPLOYEE

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Print Full Name of Employee

NEW PARAGRAPH FOR STOCK OPTION AGREEMENTS inserted after Paragraph 5

6. Change of Control

A. Notwithstanding Section 2(a) hereof, the entire option shall become immediately and fully exercisable on the day following a "Change of Control" and shall remain fully exercisable until either exercised or expiring by its terms. A "Change of Control" means:

- (1) acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act of 1934), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 under the 1934 Act) which results in the beneficial ownership by such Person of 25% or more of either
  - (a) the then outstanding shares of Common Stock of the Company (the "Outstanding Company Common Stock") or
  - (b) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities");

provided, however, that the following acquisitions will not result in a Change of Control:

- (i) an acquisition directly from the Company,
- (ii) an acquisition by the Company,
- (iii) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
- (iv) an acquisition by any Person who is deemed to have beneficial ownership of the Common Shares or other voting securities of the Company owned by the Trust Under the Will of Clarissa L. Gray ("Trust Person"), provided that such acquisition does not result in the beneficial ownership by such Person of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, and provided further that for purposes of this Section 6, a Trust Person shall not be deemed to have beneficial ownership of the Common Shares or other voting securities of the Company owned by The Graco Foundation or any employee benefit plan of the Company, including the Graco Employee Retirement Plan and the Graco Employee Stock Ownership Plan,
- (v) an acquisition by the Employee or any group that includes the Employee, or

- (vi) an acquisition by any corporation pursuant to a transaction that complies with clauses (a), (b) and (c) of subsection (4) below; and

provided, further, that if any Person's beneficial ownership of the Outstanding Company Common Stock or Outstanding Company Voting Securities is 25% or more as a result of a transaction described in clause (i) or (ii) above, and such Person subsequently acquires beneficial ownership of additional Outstanding Company Common Stock or Outstanding Company Voting Securities as a result of a transaction other than that described in clause (i) or (ii) above, such subsequent acquisition will be treated as an acquisition that causes such Person to own 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities and be deemed a Change of Control; and provided further, that in the event any acquisition or other transaction occurs which results in the beneficial ownership of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities by any Trust Person, the Incumbent Board may by majority vote increase the threshold beneficial ownership percentage to a percentage above 32% for any Trust Person; or

- (2) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board, or
- (3) the commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a Person of 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities.
- (4) The approval by the shareholders of the Company of a reorganization, merger, consolidation or statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination") or, if consummation of such Business Combination is subject, at the time of such approval by stockholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation); excluding, however, such a Business Combination pursuant to which
  - (a) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,
  - (b) no Person [excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination] beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and
  - (c) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or
- (5) approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.

B. A Change of Control shall not be deemed to have occurred with respect to an Employee if:

- (1) the acquisition of the 25% or greater interest referred to in

subparagraph A.(1) of this Section 6 is by a group, acting in concert, that includes the Employee or

(2) if at least 25% of the then outstanding common stock or combined voting power of the then outstanding company voting securities (or voting equity interests) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Company shall be beneficially owned, directly or indirectly, immediately after a reorganization, merger, consolidation, statutory share exchange, disposition of assets, liquidation or dissolution referred to in subparagraph (4) and (5) of this Section by a group, acting in concert, that includes that Employee.

C. In the event of a Change of Control, a Employee shall vest in all shares of Restricted Stock and Restricted Stock Units, effective as of the date of such Change of Control.

AMENDMENT TO  
STOCK OPTION AGREEMENT  
(NON-ISO)

This Amendment made this 14th day of April, 1997, by and between Graco Inc., a Minnesota corporation (the "Company") and \_\_\_\_\_ (the "Employee").

Whereas, the Employee and the Company entered into a Stock Option Agreement (NON-ISO) on \_\_\_\_\_ ("Agreement") which Agreement granted stock options to the Employee under the Graco Inc. Long-Term Stock Incentive Plan;

Whereas, the parties to the Agreement wish to amend it to incorporate language which will accelerate the vesting of all unvested stock options in the event of a change in control as defined in said amendment;

Now, therefore, the parties hereby mutually agree, for One Dollar and other good and valuable consideration, to amend the Agreement by inserting the attached Section 6, entitled "Change of Control" into the Agreement after Section 5 entitled "Payment of Withholding Taxes" and by renumbering Section 6 and 7 in the Agreement as Section 7 and 8, respectively.

In Witness Whereof, the parties have caused this Amendment to be executed as of the day and year first above written.

GRACO INC.

By

-----  
Its: President and CEO

EMPLOYEE

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Print Full Name of Employee

NEW PARAGRAPH FOR STOCK OPTION AGREEMENTS inserted after Paragraph 5

6. Change of Control

A. Notwithstanding Section 2(a) hereof, the entire option shall become immediately and fully exercisable on the day following a "Change of Control" and shall remain fully exercisable until either exercised or expiring by its terms. A "Change of Control" means:

- (1) acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act of 1934), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 under the 1934 Act) which results in the beneficial ownership by such Person of 25% or more of either
  - (a) the then outstanding shares of Common Stock of the Company (the "Outstanding Company Common Stock") or
  - (b) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities");

provided, however, that the following acquisitions will not result in a Change of Control:

- (i) an acquisition directly from the Company,
- (ii) an acquisition by the Company,
- (iii) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
- (iv) an acquisition by any Person who is deemed to have beneficial ownership of the Common Shares or other voting securities of the Company owned by the Trust Under the Will of Clarissa L. Gray ("Trust Person"), provided that such acquisition does not result in the beneficial ownership by such Person of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, and provided further that for purposes of this Section 6, a Trust Person shall not be deemed to have beneficial ownership of the Common Shares or other voting securities of the Company owned by The Graco Foundation or any employee benefit plan of the Company, including the Graco Employee Retirement Plan and the Graco Employee Stock Ownership Plan,
- (v) an acquisition by the Employee or any group that includes the Employee, or
- (vi) an acquisition by any corporation pursuant to a



transaction that complies with clauses (a), (b) and (c) of subsection (4) below; and

provided, further, that if any Person's beneficial ownership of the Outstanding Company Common Stock or Outstanding Company Voting Securities is 25% or more as a result of a transaction described in clause (i) or (ii) above, and such Person subsequently acquires beneficial ownership of additional Outstanding Company Common Stock or Outstanding Company Voting Securities as a result of a transaction other than that described in clause (i) or (ii) above, such subsequent acquisition will be treated as an acquisition that causes such Person to own 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities and be deemed a Change of Control; and provided further, that in the event any acquisition or other transaction occurs which results in the beneficial ownership of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities by any Trust Person, the Incumbent Board may by majority vote increase the threshold beneficial ownership percentage to a percentage above 32% for any Trust Person; or

- (2) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board, or
- (3) the commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a Person of 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities.
- (4) The approval by the shareholders of the Company of a reorganization, merger, consolidation or statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination") or, if consummation of such Business Combination is subject, at the time of such approval by stockholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation); excluding, however, such a Business Combination pursuant to which
  - (a) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,
  - (b) no Person [excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination] beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and
  - (c) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or
- (5) approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.

B. A Change of Control shall not be deemed to have occurred with respect to an Employee if:

- (1) the acquisition of the 25% or greater interest referred to in subparagraph A.(1) of this Section 6 is by a group, acting in concert, that includes the Employee or

- (2) if at least 25% of the then outstanding common stock or combined voting power of the then outstanding company voting securities (or voting equity interests) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Company shall be beneficially owned, directly or indirectly, immediately after a reorganization, merger, consolidation, statutory share exchange, disposition of assets, liquidation or dissolution referred to in subparagraph (4) and (5) of this Section by a group, acting in concert, that includes that Employee.
- C. In the event of a Change of Control, a Employee shall vest in all shares of Restricted Stock and Restricted Stock Units, effective as of the date of such Change of Control.

AMENDMENT TO  
STOCK OPTION AGREEMENT  
(NON-ISO)

This Amendment made this 14th day of April, 1997, by and between Graco Inc., a Minnesota corporation (the "Company") and \_\_\_\_\_ (the "Employee").

Whereas, the Employee and the Company entered into a Stock Option Agreement (NON-ISO) on \_\_\_\_\_ ("Agreement") which Agreement granted stock options to the Employee under the Graco Inc. Long-Term Stock Incentive Plan;

Whereas, the parties to the Agreement wish to amend it to incorporate language which will accelerate the vesting of all unvested stock options in the event of a change in control as defined in said amendment;

Now, therefore, the parties hereby mutually agree, for One Dollar and other good and valuable consideration, to amend the Agreement by inserting the attached Section 6, entitled "Change of Control" into the Agreement after Section 5 entitled "Payment of Withholding Taxes" and by renumbering Section 6 and 7 in the Agreement as Section 7 and 8, respectively.

In Witness Whereof, the parties have caused this Amendment to be executed as of the day and year first above written.

GRACO INC.

By

-----  
Its: President and CEO

EMPLOYEE

-----  
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Print Full Name of Employee

NEW PARAGRAPH FOR STOCK OPTION AGREEMENTS inserted after Paragraph 5

6. Change of Control

A. Notwithstanding Section 2(a) hereof, the entire option shall become immediately and fully exercisable on the day following a "Change of Control" and shall remain fully exercisable until either exercised or expiring by its terms. A "Change of Control" means:

- (1) acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act of 1934), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 under the 1934 Act) which results in the beneficial ownership by such Person of 25% or more of either
  - (a) the then outstanding shares of Common Stock of the Company (the "Outstanding Company Common Stock") or
  - (b) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities");

provided, however, that the following acquisitions will not result in a Change of Control:

- (i) an acquisition directly from the Company,
- (ii) an acquisition by the Company,
- (iii) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
- (iv) an acquisition by any Person who is deemed to have beneficial ownership of the Common Shares or other voting securities of the Company owned by the Trust Under the Will of Clarissa L. Gray ("Trust Person"), provided that such acquisition does not result in the beneficial ownership by such Person of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, and provided further that for purposes of this Section 6, a Trust Person shall not be deemed to have beneficial ownership of the Common Shares or other voting securities of the Company owned by The Graco Foundation or any employee benefit plan of the Company, including the Graco Employee Retirement Plan and the Graco Employee Stock Ownership Plan,
- (v) an acquisition by the Employee or any group that includes the Employee, or

- (vi) an acquisition by any corporation pursuant to a transaction that complies with clauses (a), (b) and (c) of subsection (4) below; and

provided, further, that if any Person's beneficial ownership of the Outstanding Company Common Stock or Outstanding Company Voting Securities is 25% or more as a result of a transaction described in clause (i) or (ii) above, and such Person subsequently acquires beneficial ownership of additional Outstanding Company Common Stock or Outstanding Company Voting Securities as a result of a transaction other than that described in clause (i) or (ii) above, such subsequent acquisition will be treated as an acquisition that causes such Person to own 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities and be deemed a Change of Control; and provided further, that in the event any acquisition or other transaction occurs which results in the beneficial ownership of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities by any Trust Person, the Incumbent Board may by majority vote increase the threshold beneficial ownership percentage to a percentage above 32% for any Trust Person; or

- (2) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board, or
- (3) the commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a Person of 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities.
- (4) The approval by the shareholders of the Company of a reorganization, merger, consolidation or statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination") or, if consummation of such Business Combination is subject, at the time of such approval by stockholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation); excluding, however, such a Business Combination pursuant to which
  - (a) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,
  - (b) no Person [excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination] beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and
  - (c) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or
- (5) approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.

B. A Change of Control shall not be deemed to have occurred with respect to an Employee if:

- (1) the acquisition of the 25% or greater interest referred to in

subparagraph A.(1) of this Section 6 is by a group, acting in concert, that includes the Employee or

(2) if at least 25% of the then outstanding common stock or combined voting power of the then outstanding company voting securities (or voting equity interests) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Company shall be beneficially owned, directly or indirectly, immediately after a reorganization, merger, consolidation, statutory share exchange, disposition of assets, liquidation or dissolution referred to in subparagraph (4) and (5) of this Section by a group, acting in concert, that includes that Employee.

C. In the event of a Change of Control, a Employee shall vest in all shares of Restricted Stock and Restricted Stock Units, effective as of the date of such Change of Control.

STOCK OPTION AGREEMENT  
(NON-ISO)

THIS AGREEMENT, made this day of \_\_\_\_\_, 199\_\_, by and between Graco Inc., a Minnesota corporation (the "Company") and (the "Employee").

WITNESSETH THAT:

WHEREAS, the Company pursuant to its Long-Term Incentive Stock Plan wishes to grant this stock option to Employee;

NOW THEREFORE, in consideration of the premises and of the mutual covenants herein contained, the parties hereto hereby agree as follows:

1. Grant of Option

The Company hereby grants to Employee, the right and option (hereinafter called the "option") to purchase all or any part of an aggregate of \_\_\_\_\_ Common Shares, par value \$1.00 per share, at the price of \$\_\_\_\_\_ per share on the terms and conditions set forth herein.

2. Duration and Exercisability

A. This option may not be exercised by Employee until the expiration of two (2) years from the date of grant, and this option shall in all events terminate ten (10) years after the date of grant. During the first two years from the date of grant of this option, no portion of this option may be exercised. Thereafter this option shall become exercisable in four cumulative installments of 25% as follows:

Date	Total Portion of Option Which is Exercisable
----	-----
Two Years after Date of Grant	25%
Three Years after Date of Grant	50%
Four Years after Date of Grant	75%
Five Years after Date of Grant	100%

In the event that Employee does not purchase in any one year the full number of shares of Common Stock of the Company to which he/she is entitled under this option, he/she may, subject to the terms and conditions of Section 3 hereof, purchase such shares of Common Stock in any subsequent year during the term of this option.

B. During the lifetime of the Employee, the option shall be exercisable only by him/her and shall not be assignable or transferable by him/her otherwise than by will or the laws of descent and distribution.

3. Effect of Termination of Employment

A. In the event that Employee shall cease to be employed by the Company or its subsidiaries for any reason other than his/her gross and willful misconduct, death, retirement (as defined in Section 3(d) below), or disability (as defined in Section 3(d) below), Employee shall have the right to exercise the option at any time within one month after such termination of employment to the extent of the full number of shares he/she was entitled to purchase under the option on the date of termination, subject to the condition that no option shall be exercisable after the expiration of the term of the option.

B. In the event that Employee shall cease to be employed by the Company or its subsidiaries by reason of his/her gross and willful misconduct during the course of his/her employment, including but not limited to wrongful appropriation of Company funds or the commission of a felony, the option shall be terminated as of the date of the misconduct.

C. If the Employee shall die while in the employ of the Company or a subsidiary or within one month after termination of employment for any reason other than gross and willful misconduct and shall not have fully exercised the option, all remaining shares shall become immediately exercisable and such option may be exercised at any time within twelve months after his/her death by the executors or administrators of the Employee or by any person or persons to whom the option is transferred by will or the applicable laws of descent and distribution, and subject to the condition that no option shall be exercisable after the expiration of the term of the option.

D. If the Employee's termination of employment is due to retirement (either after attaining age 55 with 10 years of service, or attaining age 65, or due to disability within the meaning of the provisions of the Graco Long-Term Disability Plan), all remaining shares shall become immediately exercisable and the option may be

exercised by the Employee at any time within three years of the employee's retirement, or in the event of the death of the Employee within the three-year period after retirement, the option may be exercised at any time within twelve months after his/her death by the executors or administrators of the Employee or by any person or persons to whom the option is transferred by will or the applicable laws of descent and distribution, to the extent of the full number of shares he/she was entitled to purchase under the option on the date of death, and subject to the condition that no option shall be exercisable after the expiration of the term of the option.

#### 4. Manner of Exercise

- A. The option can be exercised only by Employee or other proper party within the option period delivering written notice to the Company at its principal office in Minneapolis, Minnesota, stating the number of shares as to which the option is being exercised and, except as provided in Section 4(c), accompanied by payment-in-full of the option price for all shares designated in the notice.
- B. The Employee may, at Employee's election, pay the option price either by check (bank check, certified check, or personal check) or by delivering to the Company for cancellation Common Shares of the Company with a fair market value equal to the option price. For these purposes, the fair market value of the Company's Common Shares shall be the closing price of the Common Shares on the date of exercise on the New York Stock Exchange (the "NYSE") or on the principal national securities exchange on which the shares are traded if the shares are not then traded on the NYSE. If there is not a quotation available for such day, then the closing price on the next preceding day for which such a quotation exists shall be determinative of fair market value. If the shares are not then traded on an exchange, the fair market value shall be the average of the closing bid and asked prices of the Common Shares as reported by the National Association of Securities Dealers Automated Quotation System. If the Common Shares are not then traded on NASDAQ or on an exchange, then the fair market value shall be determined in such manner as the Company shall deem reasonable.
- C. The Employee may, with the consent of the Company, pay the option price by arranging for the immediate sale of some or all of the shares issued upon exercise of the option by a securities dealer and the payment to the Company by the securities dealer of the option exercise price.

#### 5. Payment of Withholding Taxes

Upon exercise of any portion of this option, Employee shall pay to the Company an amount sufficient to satisfy any federal, state, or local withholding tax requirements which arise as a result of the exercise of the option or provide the Company with satisfactory indemnification for such payment.

#### 6. Change of Control

- A. Notwithstanding Section 2(a) hereof, the entire option shall become immediately and fully exercisable on the day following a "Change of Control" and shall remain fully exercisable until either exercised or expiring by its terms. A "Change of Control" means:

- (1) acquisition by any individual, entity, or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act of 1934), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 under the 1934 Act) which results in the beneficial ownership by such Person of 25% or more of either

- (a) the then outstanding shares of Common Stock of the Company (the "Outstanding Company Common Stock") or

- (b) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities");

provided, however, that the following acquisitions will not result in a Change of Control:

- (i) an acquisition directly from the Company,

- (ii) an acquisition by the Company,

- (iii) an acquisition by an employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,

- (iv) an acquisition by any Person who is deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by the Trust Under the Will of Clarissa L. Gray ("Trust Person"), provided that such acquisition does not result in the beneficial ownership by such Person

of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, and provided further that for purposes of this Section 6, a Trust Person shall not be deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by The Graco Foundation or any employee benefit plan of the Company, including, without limitations, the Graco Employee Retirement Plan and the Graco Employee Stock Ownership Plan,

- (v) an acquisition by the Employee or any group that includes the Employee, or
- (vi) an acquisition by any corporation pursuant to a transaction that complies with clauses (a), (b), and (c) of subsection (4) below; and

provided, further, that if any Person's beneficial ownership of the Outstanding Company Common Stock or Outstanding Company Voting Securities is 25% or more as a result of a transaction described in clause (i) or (ii) above, and such Person subsequently acquires beneficial ownership of additional Outstanding Company Common Stock or Outstanding Company Voting Securities as a result of a transaction other than that described in clause (i) or (ii) above, such subsequent acquisition will be treated as an acquisition that causes such Person to own 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities and be deemed a Change of Control; and provided further, that in the event any acquisition or other transaction occurs which results in the beneficial ownership of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities by any Trust Person, the Incumbent Board may by majority vote increase the threshold beneficial ownership percentage to a percentage above 32% for any Trust Person; or

- (2) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board; or
- (3) The commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a Person of 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities; or
- (4) The approval by the shareholders of the Company of a reorganization, merger, consolidation, or statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination") or, if consummation of such Business Combination is subject, at the time of such approval by stockholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation) excluding, however, such a Business combination pursuant to which
  - (a) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,
  - (b) no Person [excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination] beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation



resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and

(c) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

(5) approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.

B. A Change of Control shall not be deemed to have occurred with respect to an Employee if:

(1) the acquisition of the 25% or greater interest referred to in subparagraph A.(1) of this Section 6 is by a group, acting in concert, that includes the Employee or

(2) if at least 25% of the then outstanding common stock or combined voting power of the then outstanding company voting securities (or voting equity interests) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Company shall be beneficially owned, directly or indirectly, immediately after a reorganization, merger, consolidation, statutory share exchange, disposition of assets, liquidation or dissolution referred to in subsections (4) or (5) of this section by a group, acting in concert, that includes that Employee.

7. Adjustments

If Employee exercises all or any portion of the option subsequent to any change in the number or character of the Common Shares of the Company (through merger, consolidation, reorganization, recapitalization, stock dividend, or otherwise), Employee shall then receive for the aggregate price paid by him/her on such exercise of the option, the number and type of securities or other consideration which he/she would have received if such option had been exercised prior to the event changing the number or character of outstanding shares.

8. Miscellaneous

A. This option is issued pursuant to the Company's Long-Term Incentive Stock Plan and is subject to its terms. A copy of the Plan has been given to the Employee. The terms of the Plan are also available for inspection during business hours at the principal offices of the company.

B. This Agreement shall not confer on Employee any right with respect to continuance of employment by the Company or any of its subsidiaries, nor will it interfere in any way with the right of the Company to terminate such employment at any time. Employee shall have none of the rights of a shareholder with respect to shares subject to this option until such shares shall have been issued to him upon exercise of this option.

C. The Company shall at all times during the term of the option reserve and keep available such number of shares as will be sufficient to satisfy the requirements of this Agreement.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed on the day and year first above written.

GRACO INC.

By

-----  
Its: Chief Executive Officer

-----  
Employee

NONEMPLOYEE DIRECTOR  
NONSTATUTORY STOCK OPTION AGREEMENT  
(NSO)

THIS AGREEMENT, made this \_\_\_\_\_ day of \_\_\_\_\_, 199\_ by and between Graco Inc., a Minnesota corporation (the "Company") and \_\_\_\_\_ (the "Nonemployee Director").

WITNESSETH THAT:

WHEREAS, the Company pursuant to its Nonemployee Director Stock Option Plan wishes to grant this stock option to Nonemployee Director.

NOW THEREFORE, in consideration of the premises and of the mutual covenants herein contained, the parties hereto hereby agree as follows:

1. Grant of Option

The Company hereby grants to Nonemployee Director, the right and option (the "Option") to purchase all or any part of an aggregate of \_\_\_\_\_ common shares, par value \$1.00 per share, at the price of \$\_\_\_\_\_ per share on the terms and conditions set forth herein. This is a nonstatutory stock Option which does not qualify for special tax treatment under Sections 421 or 422 of the Internal Revenue Code.

2. Duration and Exercisability

a. This Option may not be exercised by Employee until the expiration of one (1) year from the date of grant, and this Option shall in all events terminate ten (10) years after the date of Grant. During the first year from the date of grant of this Option, no portion of this Option may be exercised. Thereafter this Option shall become exercisable in four cumulative installments of 25% as follows:

Date ----	Total Portion of Option Which is Exercisable -----
One Year after Date of Grant	25%
Two Years after Date of Grant	50%
Three Years after Date of Grant	75%
Four Years after Date of Grant	100%

In the event that Nonemployee Director does not purchase in any one year the full number of shares of common stock of the Company to which he/she is entitled under this Option, he/she may, subject to the terms and conditions of Section 3 hereof, purchase such shares of common stock in any subsequent year during the term of this Option.

b. During the lifetime of the Nonemployee Director, the Option shall be exercisable only by him/her and shall not be assignable or transferable by him/her otherwise than by will or the laws of descent and distribution.

3. Effect of Termination of Membership on the Board

a. In the event a Nonemployee Director ceases being a director of the Company for any reason other than the reasons identified in section 3b below, the Nonemployee Director shall have the right to exercise the Option as follows, subject to the condition that no Option shall be exercisable after the expiration of the term of the Option:

(1) If the Nonemployee Director was a member of the Board of Directors of the Company for five (5) or more years, the option becomes immediately exercisable upon the date the Nonemployee Director ceases being a director. The Nonemployee Director may exercise the Option for a period of thirty six (36) months from the date the Nonemployee Director ceased being a director, provided that if the Nonemployee Director dies before the thirty-six (36) month period has expired, the Option may be exercised by the Nonemployee Director's legal representative or any person who acquires the right to exercise an Option by reason of the Nonemployee Director's death for a period of twelve (12) months from the date of the Nonemployee Director's death.

(2) If the Nonemployee Director was a member of the Board of Directors of the Company for less than five (5) years, the Nonemployee Director may exercise the Option, to the extent the Option was exercisable at the date the Nonemployee Director ceases being a member of the Board, for a period of thirty (30) days following the date the Nonemployee Director ceased being a director, provided that, if the Nonemployee Director dies before the thirty (30) day period has expired, the Option may be exercised by the Nonemployee Director's

legal representative, or any person who acquires the right to exercise an Option by reason of the Nonemployee Director's death, for a period of twelve (12) months from the date of the Nonemployee Director's death.

(3) If the Nonemployee Director dies while a member of the Board of Directors of the Company, the Option, to the extent exercisable by the Nonemployee Director at the date of death, may be exercised by the Nonemployee Director's legal representative, or any person who acquires the right to exercise an Option by reason of the Nonemployee Director's death, for a period of twelve (12) months from the date of the Nonemployee Director's death.

(4) In the event the Option is exercised by the executors, administrators, legatees, or distributees of the estate of a deceased optionee, the Company shall be under no obligation to issue stock thereunder unless and until the Company is satisfied that the person or persons exercising the Option are the duly appointed legal representatives of the deceased optionee's estate or the proper legatees or distributees thereof.

b. If a Nonemployee Director ceases being a director of the Company due to an act of (a) fraud or intentional misrepresentation or (b) embezzlement, misappropriation or conversion of assets or opportunities of the Company or any Affiliate of the Company or (c) any other gross or willful misconduct, as determined by the Board, in its sole and conclusive discretion, the Option granted to such Nonemployee Director shall immediately be forfeited as of the date of the misconduct.

#### 4. Manner of Exercise

a. The Option can be exercised only by Nonemployee Director or other proper party within the Option period by delivering written notice to the Company at its principal office in Minneapolis, Minnesota, stating the number of shares as to which the Option is being exercised and, except as provided in sections 4b(2) and 4b(3) below, accompanied by payment in full of one hundred percent (100%) of the Option price.

b. The Nonemployee Director may, at his/her election, pay the Option price as follows:

(1) by cash or by certified check,

(2) by delivery of shares of common stock to the Company, which shall have been owned for at least six (6) months and have a fair market value per share on the date of surrender equal to the exercise price, or

(3) by delivery to Company of a properly executed exercise notice together with irrevocable instructions to a broker to promptly deliver to the Company from sale or loan proceeds the amount required to pay the exercise price.

For purposes of subsection 4b(2) hereunder, the fair market value per share is the last sale price reported on the composite tape by the New York Stock Exchange on the business day immediately preceding the date as of which fair market value is being determined or, if there were no sales of shares of the Company's common stock reported on the composite tape on such day, on the most recently preceding day on which there were sales, or if the shares of the Company's stock are not listed or admitted to trading on the New York Stock Exchange on the day as of which the determination is made, the amount determined by the Board or its delegate to be the fair market value of a share on such day.

c. Such Option price shall be subject to adjustment as provided in Section 6 hereof.

#### 5. Change of Control

a. Notwithstanding Section 2(a) hereof, all outstanding Options not yet exercisable shall become immediately and fully exercisable on the day following a "Change of Control" and shall remain fully exercisable until either exercised or expiring by their terms. A "Change of Control" means:

(1) acquisition by any individual, entity, or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act of 1934), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 under the 1934 Act) which results in the beneficial ownership by such Person of 25% or more of either

(a) the then outstanding shares of common stock of the Company (the "Outstanding Company Common Stock") or

(b) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities");

provided, however, that the following acquisitions will not result in a Change of Control:

- (i) an acquisition directly from the Company,
- (ii) an acquisition by the Company,
- (iii) an acquisition by an employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
- (iv) an acquisition by any Person who is deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by the Trust Under the Will of Clarissa L. Gray ("Trust Person"), provided that such acquisition does not result in the beneficial ownership by such Person of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, and provided further that for purposes of this Section 9, a Trust Person shall not be deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by The Graco Foundation or any employee benefit plan of the Company, including, without limitations, the Graco Employee Retirement Plan and the Graco Employee Stock Ownership Plan,
- (v) an acquisition by the Nonemployee Director or any group that includes the Nonemployee Director, or
- (vi) an acquisition by any corporation pursuant to a transaction that complies with clauses (a), (b), and (c) of subsection (4) below; and

provided, further, that if any Person's beneficial ownership of the Outstanding Company Common Stock or Outstanding Company Voting Securities is 25% or more as a result of a transaction described in clause (i) or (ii) above, and such Person subsequently acquires beneficial ownership of additional Outstanding Company Common Stock or Outstanding Company Voting Securities as a result of a transaction other than that described in clause (i) or (ii) above, such subsequent acquisition will be treated as an acquisition that causes such Person to own 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities and be deemed a Change of Control; and provided further, that in the event any acquisition or other transaction occurs which results in the beneficial ownership of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities by any Trust Person, the Incumbent Board may by majority vote increase the threshold beneficial ownership percentage to a percentage above 32% for any Trust Person; or

- (2) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board; or
- (3) The commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a Person of 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities; or
- (4) The approval by the shareholders of the Company of a reorganization, merger, consolidation, or statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination") or, if consummation of such Business Combination is subject, at the time of such approval by stockholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation) excluding, however, such a Business combination pursuant to which
  - (a) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may

be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,

(b) no Person [excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination] beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and

(c) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

(5) approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.

b. A Change of Control shall not be deemed to have occurred with respect to a Nonemployee Director if:

(1) the acquisition of the 25% or greater interest referred to in subsection a(1) of this Section 5 is by a group, acting in concert, that includes the Nonemployee Director or

(2) if at least 25% of the then outstanding common stock or combined voting power of the then outstanding company voting securities (or voting equity interests) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Company shall be beneficially owned, directly or indirectly, immediately after a reorganization, merger, consolidation, statutory share exchange, disposition of assets, liquidation or dissolution referred to in subsections (4) or (5) of this section by a group, acting in concert, that includes that Nonemployee Director.

## 6. Adjustments and Changes in the Stock

a. If Nonemployee Director exercises all or any portion of the Option subsequent to any change in the common stock of the Company by reason of any stock dividend, stock split, spin-off, split-up, merger, consolidation, recapitalization, reclassification, combination or exchange of shares, or any other similar corporate event, the aggregate number of shares available under the Plan, and the number and the price of shares of common stock subject to outstanding Options shall be appropriately adjusted automatically.

b. No right to purchase fractional shares shall result from any adjustment in the Option pursuant to sub section 5a of this Agreement. In case of any such adjustment, the shares subject to the Option shall be rounded down to the nearest whole share.

c. Notice of any adjustment shall be given by the Company to Nonemployee Director for the Option which shall have been so adjusted and such adjustment (whether or not such notice is given) shall be effective and binding for all purposes of the Plan.

## 7. Miscellaneous

a. This Option is issued pursuant to the Company's Nonemployee Director Stock Option Plan and is subject to its terms. A copy of the Plan has been given to the Nonemployee Director. The terms of the Plan are also available for inspection during business hours at the principal offices of the Company.

b. This Agreement shall not confer on Nonemployee Director or other person any claim or right to be granted an Option under the Plan, except as expressly provided in the Plan. Neither the Plan nor any action taken hereunder shall be construed as giving Nonemployee Director any right to be retained in the service of the Company.

c. Neither Nonemployee Director, the Nonemployee Director's legal representative, nor any person who acquires the right to exercise this Option by reason of the Nonemployee Director's death shall be or have any of the rights or privileges of, a shareholder of the Company in respect of any shares of common stock receivable upon the exercise of this Option, in whole or in part, unless and until certificates for such shares shall have been issued upon exercise of this Option.

- d. The Company shall at all times during the term of the Option reserve and keep available such number of shares as will be sufficient to satisfy the requirements of this Agreement.
- e. This Agreement will be governed by and constructed exclusively in accordance with the laws of the State of Minnesota.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed on the day and year first above written.

GRACO INC.

By \_\_\_\_\_  
Its

\_\_\_\_\_  
Nonemployee Director

GRACO EXECUTIVE  
LONG TERM INCENTIVE AGREEMENT

(Restricted Stock Award)

This Agreement is made as of the 6th day of May, 1997, between Graco Inc., a Minnesota corporation (the "Company"), and George Aristides ("Mr. Aristides") pursuant to the Graco Inc. Long Term Stock Incentive Plan (the "Plan"). Unless otherwise defined herein, terms used herein shall have the meanings assigned to them under the Plan.

WITNESSETH:

WHEREAS, in view of the key role Mr. Aristides has played in the success of the Company, and the desire of the Board of Directors that he continue to serve as Chief Executive Officer, the Management Organization and Compensation Committee (the "Committee") now believes that it is appropriate to make an award of restricted Common Shares to Mr. Aristides; and

WHEREAS, the Plan contemplates that a restricted stock award should be evidenced by a written agreement, executed by the Company and Mr. Aristides containing such restrictions, terms and conditions as may be required by the Plan and the Committee;

NOW THEREFORE, in consideration of the premises and mutual agreements hereinafter set forth, Mr. Aristides and the Company hereby agree as follows:

1. Award.

The Company, effective as of the date of this Agreement, hereby grants to Mr. Aristides an award (the "Award") of 45,000 Common Shares \$1.00 par value, of the Company ("Common Shares") subject to the restrictions, terms and conditions set forth below and in the Plan.

2. Vesting of Stock.

(a) The Common Shares awarded by this Agreement shall vest in Mr. Aristides as follows: 10,000 shares on March 31, 1998; 15,000 shares on March 31, 1999; and 20,000 shares on March 31, 2000. If Mr. Aristides remains continuously employed by the Company until each of the vesting dates set forth above, then the Common Shares designated to vest on such vesting date shall so vest.

(b) In the event of a "Change of Control", any unvested portion of the Award shall vest. A "Change of Control" means:

(i) acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act of 1934), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 under the 1934 Act) which results in the beneficial ownership by such Person of 25% or more of either

- A. the then outstanding shares of common stock of the Company (the "Outstanding Company Common Stock") or
- B. the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities");

provided, however, that the following acquisitions will not result in a Change of Control:

- (1) an acquisition directly from the Company,
- (2) an acquisition by the Company,
- (3) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
- (4) an acquisition by any Person who is deemed to have beneficial ownership of the Company common stock or other Company voting securities owned immediately after said acquisition by the Trust Under the Will of Clarissa L. Gray ("Trust Person"), provided that such acquisition does not result in the beneficial ownership by such Person of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, and provided further that for purposes of this Section 2, a Trust Person shall not be deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by The Graco Foundation or any employee benefit plan of the Company, including without limitation the Graco Employee Retirement Plan and the Graco Employee Stock Ownership Plan,
- (5) an acquisition by Mr. Aristides or any group that includes Mr. Aristides, or
- (6) an acquisition by any corporation pursuant to a

transaction that complies with clauses (A), (B) and (C) of Section 2 (a)(iii) below; and

provided, further, that if any Person's beneficial ownership of the Outstanding Company Common Stock or Outstanding Company Voting Securities is 25% or more as a result of a transaction described in clause (1) or (2) above, and such Person subsequently acquires beneficial ownership of additional Outstanding Company Common Stock or Outstanding Company Voting Securities as a result of a transaction other than that described in clause (1) or (2) above, such subsequent acquisition will be treated as an acquisition that causes such Person to own 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities and be deemed a Change of Control; and provided further, that in the event any acquisition or other transaction occurs which results in the beneficial ownership of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities by any Trust Person, the Incumbent Board may by majority vote increase the threshold beneficial ownership percentage to a percentage above 32% for any Trust Person; or

- (ii) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board; or
- (iii) The commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a Person of 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities; or
- (iv) The approval by the shareholders of the Company of a reorganization, merger, consolidation or statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination") or, if consummation of such Business Combination is subject, at the time of such approval by stockholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation); excluding, however, such a Business Combination pursuant to which
  - A. all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,
  - B. no Person [excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination] beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and
  - C. at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or
- (v) approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.
- (vi) A Change of Control shall not be deemed to have occurred with respect to Mr. Aristides if:
  - (A) the acquisition of the 25% or greater interest referred to in Section 2(b)(i) is by a group, acting in concert, that includes Mr. Aristides; or



- (B) if at least 25% of the then outstanding common stock or combined voting power of the then outstanding company voting securities (or voting equity interests) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Company shall be beneficially owned, directly or indirectly, immediately after a reorganization, merger, consolidation, statutory share exchange, disposition of assets, liquidation or dissolution referred to in subsections (iv) and (v) of this Section 2(b) by a group, acting in concert, that includes Mr. Aristides.
- (c) Any unvested portion of the Award shall vest in the event that the employment of Mr. Aristides is terminated:
  - (i) by the Board of Directors other than "for cause" (as defined in Section 3(b) below);
  - (ii) as a result of the mutual agreement of Mr. Aristides and the Board of Directors that the continuation of such employment is not appropriate; or
  - (iii) by Mr. Aristides if the Board takes action to prevent the implementation, or fails to take action to enable the implementation, of an initiative, action or strategy that Mr. Aristides believes is necessary or appropriate for the Company to fulfill its mission or achieve its vision.
- (d) Until a Common Share vests, Mr. Aristides acknowledges that he may not, and agrees that he shall not, transfer his rights to such Common Share. Until a Common Share vests, no attempt to transfer such Common Share, whether voluntary or involuntary, by operation of law or otherwise, shall vest the transferee with any interest or right in or with respect to such Common Share.

### 3. Termination.

- (a) If Mr. Aristides ceases to be an employee by reason of disability (as determined under the Company's Long Term Disability Plan) or death prior to the last vesting date, then Mr. Aristides or his estate shall be entitled to receive the remaining then unvested portion of the Award. No transfer, by will or by the laws of descent and distribution, of the Common Shares which vest by reason of Mr. Aristides' death shall be effective to bind the Company unless the Committee shall have been furnished with (i) written notice thereof and a copy of the will and/or such other evidence as the Committee may deem necessary to establish the validity of the transfer and (ii) an agreement by the transferee to comply with the terms and conditions of this Agreement that were or would have been applicable to Mr. Aristides.
- (b) If Mr. Aristides ceases to be employee of the Company prior to the last vesting date because of his voluntary resignation or retirement (other than as set forth in Section 2(c)(iii) above), termination for cause (as defined below), or otherwise other than by reason of disability or death, Mr. Aristides' rights to any unvested portion of this Award shall be immediately and irrevocably forfeited. As used in this Agreement, the term "for cause" shall mean as a result of gross or willful misconduct, a knowing breach of fiduciary duty, or conviction of a felony involving moral turpitude.

### 4. Issuance and Custody of Certificate.

- (a) The Company shall cause to be issued one or more stock certificates, registered in the name of Mr. Aristides evidencing the restricted Common Shares awarded pursuant to Section 1. Each such certificate shall bear the following legend:

The shares of stock represented by this certificate are subject to forfeiture and the transferability of this certificate and the shares of stock represented hereby are subject to the restrictions, terms and conditions (including restrictions against transfer) contained in the Graco Inc. Long Term Stock Incentive Plan and an Agreement entered into between the registered owner of such shares and Graco Inc. A copy of the Plan and Agreement is on file in the office of the Secretary of Graco Inc., 4050 Olson Memorial Highway, Golden Valley, Minnesota.
- (b) Each certificate issued pursuant to Section 4(a), together with the stock powers relating to such Common Shares, shall be deposited by the Company with the Secretary of the Company or a custodian designated by such Secretary. The Secretary or such custodian shall issue a receipt to Mr. Aristides evidencing the certificates held which are registered in the name of Mr. Aristides.
- (c) Promptly after any Common Shares vest pursuant to Section 3 of this Agreement, the Company shall cause to be issued certificates evidencing such Common Shares, free of the legend provided in Section 4(a) and shall cause such certificates to be delivered to Mr. Aristides (or Mr. Aristides' legal representatives, beneficiaries or heirs).
- (d) Mr. Aristides shall not be deemed for any purpose to be, or have rights as, a shareholder of the Company by virtue of the Award, until a stock certificate is issued therefor pursuant to Section 4(a).

5. Agreements of Mr. Aristides.

Mr. Aristides acknowledges that: (a) this Agreement is not a contract of employment and the terms of Mr. Aristides' employment shall not be affected in any way by this Agreement except as specifically provided in the Agreement; (b) the Award made by this Agreement shall not confer any legal rights upon Mr. Aristides for continuation of employment or interfere with or limit the right of the Company to terminate Mr. Aristides' employment at any time; (c) the Board may amend, suspend or terminate the Plan or any part thereof at any time provided that no amendment, suspension or termination shall be made or effected which would adversely affect any right of Mr. Aristides with respect to the Award made by this Agreement without the written consent of Mr. Aristides unless such amendment, termination or suspension is required by applicable law; (e) and Mr. Aristides shall not make an election pursuant to Section 83(b) of the Internal Revenue Code of 1986, with respect to the Award.

6. Legal Compliance Restrictions.

The Company shall not be obligated to issue or deliver any certificates evidencing Common Shares awarded by this Agreement unless and until the Company is advised by its counsel that the issuance and delivery of such certificates are in compliance with all applicable laws, regulations of governmental authorities and the requirements of the New York Stock Exchange or any other exchange upon which Common Shares are traded.

The Company shall not be obligated to register any securities pursuant to the Securities Act of 1933 (as now in effect or as hereinafter amended) or to take any other affirmative action in order to cause the issuance and delivery of such certificates to comply with any such law, regulation or requirement. The Committee may require, as a condition of the issuance and delivery of such certificates and in order to ensure compliance with such laws, regulations and requirements, that Mr. Aristides make such agreements and representations as the Committee, in its sole discretion, deems necessary or desirable.

7. Withholding Taxes.

Mr. Aristides agrees to pay or make arrangements for the payment to the Company of the amount of any taxes that the Company is required by law to withhold with respect to the Award made by this Agreement. Such payment shall be due on the date the Company is required to withhold such taxes. In the event that such payment is not made when due, the Company shall have the right (a) to retain, or sell within 10 days notice or such longer notice as may be required by applicable law, a sufficient number of the Common Shares subject to any Award made to Mr. Aristides in order to cover all or part of the amount required to be withheld; (b) to deduct, to the extent permitted by law, from any payment of any kind otherwise due to such person from the Company all or a part of the amount required to be withheld or (c) to pursue any other remedy at law or in equity. The Committee, in its sole discretion and subject to such rules as it may adopt, may allow Mr. Aristides to satisfy any such tax obligation, in whole or in part, by (i) electing to have the Company withhold Common Shares otherwise to be delivered with a fair market value equal to the amount of such tax obligation, or (ii) electing to surrender to the Company previously owned Common Shares with a fair market value equal to the amount of such tax obligation. The election must be made on or before the date that the amount of tax to be withheld is determined.

8. Stock Splits, Recapitalizations, Acquisitions, etc.

(a) In the event of any change in the number of outstanding Common Shares by reason of any stock dividend or split, recapitalization, merger, consolidation, combination or exchange of shares or similar corporate change, the number and kind of shares subject to this Award shall be appropriately adjusted by the Committee. If changes in capitalization of the Company other than those referred to above shall occur, the Committee may, but need not, make such adjustments in the number and kind of shares available under this Award as the Committee may deem appropriate.

To the extent permitted by applicable law, the Award of a Common Share shall be adjusted so that Mr. Aristides shall have the right to receive under the Award and subject to the Plan securities and other property (except regular quarterly cash dividends) with respect to the Award as a result of any stock dividend or split, special cash dividend, recapitalization, merger, consolidation, combination of shares or exchange of shares or similar corporate change or otherwise substantially similar to that Mr. Aristides would have received with respect to the Common Shares had Mr. Aristides owned the Common Shares free and clear of the restriction of the Plan. Unless the Committee otherwise determines, Mr. Aristides' right in respect of such securities and other property shall not vest until such Common Share would have vested and no such securities or other property shall be issued or delivered until such Common Share would be issued or delivered.

(b) Unless the Committee otherwise determines, any securities and other property (except regular quarterly cash dividends) received by Mr. Aristides as a result of a corporate change described in Section 8(a) or otherwise with respect to a Common Share prior to the date such Common Share vests shall be promptly deposited with the Secretary or the custodian designated by the Secretary to be held in custody in accordance with Section 4(b) as though such securities and other property were part of such Common Share.

9. Notices.

Any notice which either party hereto or the Committee may be required or permitted to give to the other with respect to the Plan or this Agreement shall be in writing, and may be delivered personally or by mail, postage prepaid, addressed as follows:

(a) if to the Company:

Graco Inc.  
P.O. Box 1441  
Minneapolis, MN 55440-1441  
Attention: Vice President, Human Resources

(b) if to the Committee:

Management Organization and Compensation Committee  
c/o Vice President, Human Resources  
Graco Inc.  
P.O. Box 1441  
Minneapolis, MN 55440-1441

(c) if to Mr. Aristides:

Mr. George Aristides  
Chief Executive Officer  
Graco Inc.  
P.O. Box 1441  
Minneapolis, MN 55440-1441

or to such other address as the person to whom the notice is directed shall have designated in writing to others.

10. Minnesota Law.

This Agreement is made and accepted in the State of Minnesota. The laws of the State of Minnesota shall control the interpretation and performance of the terms of the Plan and of this Agreement.

11. Binding Effect.

This Agreement shall be binding upon, and shall inure to the benefit of, the respective successors, assigns, heirs, executors, administrators and guardians of the parties hereto.

IN WITNESS WHEREOF, the Company and Mr. Aristides have caused this Agreement to be executed and delivered, all as of the day and year first above written.

-----  
George Aristides

GRACO INC.

By

-----  
David A. Koch  
Chairman

STOCK OPTION AGREEMENT  
(NON-ISO)

THIS AGREEMENT, made this \_\_\_\_\_ day of \_\_\_\_\_, 199\_\_, by and between Graco Inc., a Minnesota corporation (the "Company") and (the "Employee").

WITNESSETH THAT:

WHEREAS, the Company pursuant to its Long-Term Incentive Stock Plan wishes to grant this stock option to Employee;

NOW THEREFORE, in consideration of the premises and of the mutual covenants herein contained, the parties hereto hereby agree as follows:

1. Grant of Option

The Company hereby grants to Employee, the right and option (hereinafter called the "option") to purchase all or any part of an aggregate of \_\_\_\_\_ Common Shares, par value \$1.00 per share, at the price of \$\_\_\_\_\_ per share on the terms and conditions set forth herein.

2. Duration and Exercisability

A. This option may not be exercised by Employee until the expiration of two (2) years from the date of grant, and this option shall in all events terminate ten (10) years after the date of grant. During the first two years from the date of grant of this option, no portion of this option may be exercised. Thereafter this option shall become exercisable in four cumulative installments of 25% as follows:

Date ----	Total Portion of Option Which is Exercisable -----
Two Years after Date of Grant	25%
Three Years after Date of Grant	50%
Four Years after Date of Grant	75%
Five Years after Date of Grant	100%

In the event that Employee does not purchase in any one year the full number of shares of Common Stock of the Company to which he/she is entitled under this option, he/she may, subject to the terms and conditions of Section 3 hereof, purchase such shares of Common Stock in any subsequent year during the term of this option.

B. During the lifetime of the Employee, the option shall be exercisable only by him/her and shall not be assignable or transferable by him/her otherwise than by will or the laws of descent and distribution.

3. Effect of Termination of Employment

A. In the event that Employee shall cease to be employed by the Company or its subsidiaries for any reason other than his/her gross and willful misconduct, death, retirement (as defined in Section 3(d) below), or disability (as defined in Section 3(d) below), Employee shall have the right to exercise the option at any time within one month after such termination of employment to the extent of the full number of shares he/she was entitled to purchase under the option on the date of termination, subject to the condition that no option shall be exercisable after the expiration of the term of the option.

B. In the event that Employee shall cease to be employed by the Company or its subsidiaries by reason of his/her gross and willful misconduct during the course of his/her employment, including but not limited to wrongful appropriation of Company funds or the commission of a felony, the option shall be terminated as of the date of the misconduct.

C. If the Employee shall die while in the employ of the Company or a subsidiary or within one month after termination of employment for any reason other than gross and willful misconduct and shall not have fully exercised the option, all remaining shares shall become immediately exercisable and such option may be exercised at any time within twelve months after his/her death by the executors or administrators of the Employee or by any person or persons to whom the option is transferred by will or the applicable laws of descent and distribution, and subject to the condition that no option shall be exercisable after the expiration of the term of the option.

D. If the Employee's termination of employment is due to retirement (either after attaining age 55 with 10 years of service, or attaining age 65, or due to disability within the meaning of the provisions of the Graco Long-Term Disability Plan), all remaining shares shall become immediately exercisable and the option may be exercised by the Employee at any time within three years of the

employee's retirement, or in the event of the death of the Employee within the three-year period after retirement, the option may be exercised at any time within twelve months after his/her death by the executors or administrators of the Employee or by any person or persons to whom the option is transferred by will or the applicable laws of descent and distribution, to the extent of the full number of shares he/she was entitled to purchase under the option on the date of death, and subject to the condition that no option shall be exercisable after the expiration of the term of the option.

#### 4. Manner of Exercise

- A. The option can be exercised only by Employee or other proper party within the option period delivering written notice to the Company at its principal office in Minneapolis, Minnesota, stating the number of shares as to which the option is being exercised and, except as provided in Section 4(c), accompanied by payment-in-full of the option price for all shares designated in the notice.
- B. The Employee may, at Employee's election, pay the option price either by check (bank check, certified check, or personal check) or by delivering to the Company for cancellation Common Shares of the Company with a fair market value equal to the option price. For these purposes, the fair market value of the Company's Common Shares shall be the closing price of the Common Shares on the date of exercise on the New York Stock Exchange (the "NYSE") or on the principal national securities exchange on which the shares are traded if the shares are not then traded on the NYSE. If there is not a quotation available for such day, then the closing price on the next preceding day for which such a quotation exists shall be determinative of fair market value. If the shares are not then traded on an exchange, the fair market value shall be the average of the closing bid and asked prices of the Common Shares as reported by the National Association of Securities Dealers Automated Quotation System. If the Common Shares are not then traded on NASDAQ or on an exchange, then the fair market value shall be determined in such manner as the Company shall deem reasonable.
- C. The Employee may, with the consent of the Company, pay the option price by arranging for the immediate sale of some or all of the shares issued upon exercise of the option by a securities dealer and the payment to the Company by the securities dealer of the option exercise price.

#### 5. Payment of Withholding Taxes

Upon exercise of any portion of this option, Employee shall pay to the Company an amount sufficient to satisfy any federal, state, or local withholding tax requirements which arise as a result of the exercise of the option or provide the Company with satisfactory indemnification for such payment.

#### 6. Change of Control

- A. Notwithstanding Section 2(a) hereof, the entire option shall become immediately and fully exercisable on the day following a "Change of Control" and shall remain fully exercisable until either exercised or expiring by its terms. A "Change of Control" means:

- (1) acquisition by any individual, entity, or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act of 1934), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 under the 1934 Act) which results in the beneficial ownership by such Person of 25% or more of either

- (a) the then outstanding shares of Common Stock of the Company (the "Outstanding Company Common Stock") or
- (b) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities");

provided, however, that the following acquisitions will not result in a Change of Control:

- (i) an acquisition directly from the Company,
- (ii) an acquisition by the Company,
- (iii) an acquisition by an employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
- (iv) an acquisition by any Person who is deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by the Trust Under the Will of Clarissa L. Gray ("Trust Person"), provided that such acquisition does not result in the beneficial ownership by such Person of 32% or more of either the Outstanding Company

Common Stock or the Outstanding Company Voting Securities, and provided further that for purposes of this Section 6, a Trust Person shall not be deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by The Graco Foundation or any employee benefit plan of the Company, including, without limitations, the Graco Employee Retirement Plan and the Graco Employee Stock Ownership Plan,

- (v) an acquisition by the Employee or any group that includes the Employee, or
- (vi) an acquisition by any corporation pursuant to a transaction that complies with clauses (a), (b), and (c) of subsection (4) below; and

provided, further, that if any Person's beneficial ownership of the Outstanding Company Common Stock or Outstanding Company Voting Securities is 25% or more as a result of a transaction described in clause (i) or (ii) above, and such Person subsequently acquires beneficial ownership of additional Outstanding Company Common Stock or Outstanding Company Voting Securities as a result of a transaction other than that described in clause (i) or (ii) above, such subsequent acquisition will be treated as an acquisition that causes such Person to own 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities and be deemed a Change of Control; and provided further, that in the event any acquisition or other transaction occurs which results in the beneficial ownership of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities by any Trust Person, the Incumbent Board may by majority vote increase the threshold beneficial ownership percentage to a percentage above 32% for any Trust Person; or

- (2) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board; or
- (3) The commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a Person of 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities; or
- (4) The approval by the shareholders of the Company of a reorganization, merger, consolidation, or statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination") or, if consummation of such Business Combination is subject, at the time of such approval by stockholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation) excluding, however, such a Business combination pursuant to which
  - (a) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,
  - (b) no Person [excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination] beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting

securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and

(c) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

(5) approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.

B. A Change of Control shall not be deemed to have occurred with respect to an Employee if:

(1) the acquisition of the 25% or greater interest referred to in subparagraph A.(1) of this Section 6 is by a group, acting in concert, that includes the Employee or

(2) if at least 25% of the then outstanding common stock or combined voting power of the then outstanding company voting securities (or voting equity interests) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Company shall be beneficially owned, directly or indirectly, immediately after a reorganization, merger, consolidation, statutory share exchange, disposition of assets, liquidation or dissolution referred to in subparagraph (4) and (5) of this section by a group, acting in concert, that includes that Employee.

7. Adjustments

If Employee exercises all or any portion of the option subsequent to any change in the number or character of the Common Shares of the Company (through merger, consolidation, reorganization, recapitalization, stock dividend, or otherwise), Employee shall then receive for the aggregate price paid by him/her on such exercise of the option, the number and type of securities or other consideration which he/she would have received if such option had been exercised prior to the event changing the number or character of outstanding shares.

8. Miscellaneous

A. This option is issued pursuant to the Company's Long-Term Incentive Stock Plan and is subject to its terms. A copy of the Plan has been given to the Employee. The terms of the Plan are also available for inspection during business hours at the principal offices of the company.

B. This Agreement shall not confer on Employee any right with respect to continuance of employment by the Company or any of its subsidiaries, nor will it interfere in any way with the right of the Company to terminate such employment at any time. Employee shall have none of the rights of a shareholder with respect to shares subject to this option until such shares shall have been issued to him upon exercise of this option.

C. The Company shall at all times during the term of the option reserve and keep available such number of shares as will be sufficient to satisfy the requirements of this Agreement.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed on the day and year first above written.

GRACO INC.

By \_\_\_\_\_  
Its: Chief Executive Officer

\_\_\_\_\_  
Employee

EXHIBIT 11

GRACO INC. AND SUBSIDIARIES  
 COMPUTATION OF NET EARNINGS PER COMMON SHARE  
 (Unaudited)

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	June 27, 1997	June 28, 1996	June 27, 1997	June 28, 1996
	(In thousands except per share amounts)			
Net earnings applicable to common stock:				
Net earnings .....	\$10,418	\$10,032	\$16,599	\$15,617
	=====	=====	=====	=====
Average number of common and common equivalent shares outstanding:				
Average number of common shares outstanding .....	17,134	17,349	17,120	17,333
Dilutive effect of stock options computed on the treasury stock method .....	358	239	375	238
	-----	-----	-----	-----
	17,492	17,588	17,495	17,571
	=====	=====	=====	=====
Net earnings per common and common equivalent share .....	\$ .60	\$ .57	\$ .95	\$ .89
	=====	=====	=====	=====

Primary and fully diluted earnings per share are substantially the same.



This schedule contains summary financial information extracted from Graco Inc. and subsidiaries consolidated statements of earnings and consolidated balance sheets for the quarterly period ending June 27, 1997 and is qualified in its entirety by reference to such financial statements.

0000042888  
 GRACO INC.  
 1,000  
 U.S. DOLLARS

6-MOS		
	DEC-27-1997	
	MAR-29-1997	
	JUN-27-1997	
	1	2,258
		0
	89,903	
	4,224	
	43,405	
	149,408	191,600
	92,078	
	258,328	
81,402		12,321
0		0
		17,064
		118,479
258,328		203,820
	203,820	105,888
		105,888
	72,583	
	(69)	
	447	
	25,349	
	8,750	
16,599		0
	0	0
		0
	16,599	
	.95	
	.95	